ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
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CliftonLarsonAllen

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INDEPENDENT AUDITORS' REPORT

Board of Directors or Audit Committee
Alerus Financial Corporation and Subsidiaries
Grand Forks, North Dakota

Report on Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Alerus Financial Corporation and Subsidiaries, which comprise the consolidated balance sheet of December 31, 2014, and the related consolidated statements of income, comprehensive income, change in stockholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Board of Directors or Audit Committee
Alerus Financial Corporation and Subsidiaries

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Alerus Financial Corporation and Subsidiaries as of December 31, 2014, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Correction of Error

As described in Note 19 to the consolidated financial statements, Alerus Financial Corporation and Subsidiaries discovered and corrected an error in consolidated financial statements related to recognition of the FDIC true-up liability arising from the loss share agreements with the FDIC. Our opinion is not modified with respect to that matter.

Other Matters

Report on Internal Control over Financial Reporting

We also have audited in accordance with attestation standards established by the American Institute of Certified Public Accountants, Alerus Financial Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2014, based on criteria established in *2013 Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 20, 2015, except for Notes 13 and 19, as to which the date is March 31, 2015, expressed an adverse opinion on the Company's internal control over financial reporting because of a material weakness.

Prior Period Consolidated Financial Statements

The consolidated financial statements of Alerus Financial Corporation and Subsidiaries as of December 31, 2013 and 2012 were audited by other auditors whose report, dated February 18, 2014, expressed an unqualified opinion on those statements, before the restatement described in Note 19 to the consolidated financial statements.

As part of our audit of the 2014 consolidated financial statements, we also audited adjustments described in Note 13 and 19 that were applied to restate the 2012 and 2013 consolidated financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2012 and 2013 consolidated financial statements of the Company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2012 and 2013 consolidated financial statements as a whole.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Minneapolis, Minnesota
February 20, 2015, except for Notes 13 and 19, as to which the date is March 31, 2015

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2014 AND 2013

	2014	2013
ASSETS		
Cash and Non Interest-Bearing Due from Financial Institutions	$ 28,860,920	$ 32,227,691
Interest-Bearing Due from Financial Institutions	16,665,167	40,316,751
Cash and Cash Equivalents	45,526,087	72,544,442
Securities Held for Trading	1,960,062	1,900,828
Securities Available for Sale at Fair Value (Amortized Cost is $201,984,315 in 2014 and $222,550,980 in 2013)	204,141,263	222,879,481
Securities Held to Maturity at Amortized Cost (Fair Value $-0- in 2014 and $55,893,074 in 2013)	-	54,892,115
Loans Held for Sale	35,041,951	30,253,556
Loans - Non-Covered	1,090,026,576	894,543,258
Loans - Covered by FDIC Loss Share Agreements	5,431,733	20,021,338
Total Loans	1,095,458,309	914,564,596
Less: Allowance for Loan Losses	(17,063,497)	(16,838,125)
Net Loans	1,078,394,812	897,726,471
Premises and Equipment, Net	21,456,308	22,562,711
Accrued Interest Receivable	4,773,576	5,157,609
Bank Owned Life Insurance	27,484,406	26,663,318
Goodwill	1,260,799	664,015
Other Intangible Assets	25,018,592	15,014,174
Deferred Tax Assets, Net	14,176,744	9,636,767
Other Assets	29,071,865	21,831,025
Total Assets	$ 1,488,306,465	$ 1,381,726,512
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Noninterest-Bearing	$ 330,218,494	$ 305,042,279
Interest-Bearing	931,949,546	877,561,005
Total Deposits	1,262,168,040	1,182,603,284
Federal Funds Purchased and Repurchase Agreements	10,531,931	7,874,545
Other Borrowed Funds	21,494,009	21,629,820
Accrued Interest Payable	633,644	712,235
Accrued Expenses	8,562,372	5,806,791
Other Liabilities	13,830,871	9,789,361
Total Liabilities	1,317,220,867	1,228,416,036
STOCKHOLDERS' EQUITY		
Preferred Stock, $1 Par Value, 2,000,000 Shares Authorized, 20,000 Shares Issued, and Outstanding in 2014 and 2013, Respectively	20,000	20,000
Common Stock, $1 Par Value, 30,000,000 Shares Authorized; 13,922,013 and 4,605,012 Issued and Outstanding in 2014 and 2013, Respectively	13,922,013	4,605,012
Additional Paid-In Capital	44,323,057	41,956,191
Retained Earnings	115,257,713	109,839,915
Unearned Stock Compensation	(3,806,846)	(3,319,240)
Accumulated Other Comprehensive Income	1,369,661	208,598
Total Stockholders' Equity	171,085,598	153,310,476
Total Liabilities and Stockholders' Equity	$ 1,488,306,465	$ 1,381,726,512

See accompanying Notes to Consolidated Financial Statements.

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

	2014	2013	2012
INTEREST AND DIVIDEND INCOME			
Loans, Including Fees	$ 47,875,597	$ 43,750,152	$ 45,197,016
Investment Securities:			
Taxable	5,482,533	5,904,647	6,852,475
Exempt from Federal Income Taxes	817,005	707,179	699,388
Federal Funds Sold	17	9	2,646
Other	218,769	148,111	99,857
Total Interest and Dividend Income	54,393,921	50,510,098	52,851,382
INTEREST EXPENSE			
Deposits	2,673,066	3,100,781	3,874,208
Short Term Borrowings	22,495	29,916	64,682
Other Borrowed Funds	620,752	581,627	646,705
Total Interest Expense	3,316,313	3,712,324	4,585,595
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	51,077,608	46,797,774	48,265,787
PROVISION FOR LOAN LOSSES	400,000	(1,200,000)	(833,333)
NET INTEREST INCOME, AFTER PROVISION FOR LOAN LOSSES	51,477,608	45,597,774	47,432,454
NON-INTEREST INCOME			
Trust Income	49,306,741	43,354,945	39,392,363
Mortgage Banking	18,435,291	27,176,688	31,061,453
Service Charges on Deposit Accounts	1,626,135	1,638,668	1,626,319
Net Gain (Loss) on Investment Securities	2,179,367	(69,962)	217,088
Other	6,858,878	7,168,203	6,818,654
Total Non-Interest Income	78,406,412	79,268,542	79,115,877
NON-INTEREST EXPENSES			
Salaries	48,839,010	49,202,952	49,072,039
Employee Benefits	11,579,878	10,621,356	10,301,949
Net Occupancy Expense	4,423,942	3,790,595	4,189,032
Furniture and Equipment Expense	4,658,459	4,687,063	4,147,353
Other	30,613,683	24,610,814	33,123,669
Total Non-Interest Expenses	100,114,972	92,912,780	100,834,042
INCOME BEFORE INCOME TAXES	29,769,048	31,953,536	25,714,289
INCOME TAX EXPENSE	9,537,801	11,683,497	9,458,080
NET INCOME	20,231,247	20,270,039	16,256,209
LESS PREFERRED STOCK DIVIDENDS	200,000	200,000	339,445
NET INCOME APPLICABLE TO COMMON STOCK	$ 20,031,247	$ 20,070,039	$ 15,916,764
EARNINGS PER COMMON SHARE	$ 1.44	$ 1.46	$ 1.17
AVERAGE COMMON SHARES OUTSTANDING	13,887,344	13,762,044	13,591,335

See accompanying Notes to Consolidated Financial Statements.

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

	2014	2013	2012
NET INCOME	$ 20,231,247	$ 20,270,039	$ 16,256,209
Other Comprehensive Income, Before Tax:			
Unrealized Gains (Losses) on Available-for-Sale Securities	3,958,559	(7,280,814)	1,904,487
Reclassification Adjustment for Gains Realized in Income	(2,130,113)	(33,929)	(216,858)
Total Other Comprehensive Income (Loss), Before Tax	1,828,446	(7,314,743)	1,687,629
Income Tax Benefit (Expense) Related to Items of Other Comprehensive Income	(667,383)	2,669,880	(615,990)
Other Comprehensive Income (Loss), Net of Tax	1,161,063	(4,644,863)	1,071,639
TOTAL COMPREHENSIVE INCOME	$ 21,392,310	$ 15,625,176	$ 17,327,848

See accompanying Notes to Consolidated Financial Statements.

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Unearned Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, DECEMBER 31, 2011	$ 20,000	$ 4,483,757	$ 37,754,653	$ 82,971,796	$ (1,762,028)	$ 3,781,810	$ 127,249,988
Net Income	-	-	-	16,256,209	-	-	16,256,209
Other Comprehensive Income	-	-	-	-	-	1,071,651	1,071,651
Cash Dividend Declared Preferred - 1.7%	-	-	-	(339,445)	-	-	(339,445)
Cash Dividend Declared Common ($.94 Per Share)	-	-	-	(4,266,038)	-	-	(4,266,038)
Issued 6,216 Shares Under Director's Retainer Plan	-	6,216	153,846	-	-	-	160,062
Income Tax Benefit Equity Related Items	-	-	349,454	-	-	-	349,454
Stock-Based Compensation Expense	-	-	-	-	799,124	-	799,124
Restricted Stock Awards	-	52,835	1,346,268	-	(1,399,103)	-	-
BALANCE, DECEMBER 31, 2012	20,000	4,542,808	39,604,221	94,622,522	(2,362,007)	4,853,461	141,281,005
Net Income	-	-	-	20,270,039	-	-	20,270,039
Other Comprehensive Loss	-	-	-	-	-	(4,644,863)	(4,644,863)
Cash Dividend Declared Preferred - 1.0%	-	-	-	(200,000)	-	-	(200,000)
Cash Dividend Declared Common ($1.02 Per Share)	-	-	-	(4,688,642)	-	-	(4,688,642)
Issued 8,279 Shares Under Director's Retainer Plan	-	8,279	285,912	-	-	-	294,191
Redemption of 4,901 Share of Common Stock	-	(4,901)	(34,307)	(164,004)	-	-	(203,212)
Income Tax Benefit Equity Related Items	-	-	266,992	-	-	-	266,992
Stock-Based Compensation Expense	-	-	-	-	942,762	-	942,762
Restricted Stock Awards (Net of Forfeitures)	-	58,826	1,833,373	-	(1,899,995)	-	(7,796)
BALANCE, DECEMBER 31, 2013	20,000	4,605,012	41,956,191	109,839,915	(3,319,240)	208,598	153,310,476
Net Income	-	-	-	20,231,247	-	-	20,231,247
Other Comprehensive Income	-	-	-	-	-	1,161,063	1,161,063
Issued 5,877 Shares Under Director's Retainer Plan	-	5,877	309,130	-	-	-	315,007
3-for-1 Stock Split Effected in the Form of Dividends	-	9,281,342	-	(9,281,342)	-	-	-
Cash Dividend Declared Preferred - 1.0%	-	-	-	(200,000)	-	-	(200,000)
Cash Dividend Declared Common ($0.38 Per Share)	-	-	-	(5,332,107)	-	-	(5,332,107)
Income Tax Benefit Equity Related Items	-	-	538,637	-	-	-	538,637
Stock-Based Compensation Expense	-	-	-	-	1,061,275	-	1,061,275
Restricted Stock Awards (Net of Forfeitures)	-	29,782	1,519,099	-	(1,548,881)	-	-
BALANCE, DECEMBER 31, 2014	$ 20,000	$ 13,922,013	$ 44,323,057	$ 115,257,713	$ (3,806,846)	$ 1,369,661	$ 171,085,598

See accompanying Notes to Consolidated Financial Statements.

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

	2014	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES			
Net Income	$ 20,231,247	$ 20,270,039	$ 16,256,209
Adjustments to Reconcile Net Income to Cash Provided:			
Deferred Income Taxes	(1,726,340)	(973,926)	(3,073,405)
Provision for Loan Losses	(400,000)	1,200,000	833,333
Provision for Foreclosed Asset Losses	-	-	-
Depreciation and Amortization	8,159,525	7,464,741	7,429,941
Compensation Related Stock Plans	1,376,282	1,229,156	959,187
Investment Security Premium Amortization	1,372,098	1,783,086	2,137,474
Impairment of FDIC Indemnification Asset	-	-	5,121,173
Increase in Value of Bank Owned Life Insurance	(821,088)	(832,411)	(850,662)
Realized (Gain) Loss on Forward Sale Derivatives	91,202	172,987	(51,445)
Realized (Gain) Loss on Rate Lock Commitments	(103,987)	(133,195)	561
Realized (Gain) Loss on Sale of Premises and Equipment	162,962	(5,259)	18,562
Realized (Gain) Loss on Sale of Foreclosed Assets	545,534	298,636	(34,577)
Realized Gain on Sale of Investment Securities	(2,130,113)	(56,032)	(217,088)
Realized Gain on Servicing Rights	(1,044,529)	(2,213,586)	(1,360,747)
Net Change in:			
Securities Held for Trading	(59,234)	(156,289)	(457,759)
Loans Held for Sale	(4,788,395)	47,178,228	(28,521,892)
Accrued Interest Receivable	666,629	(523,033)	230,798
Other Assets	(6,548,422)	(1,404,738)	7,326,303
Accrued Interest Payable	(95,396)	(168,596)	(381,573)
Accrued Expenses	2,755,581	(2,943,881)	1,937,066
Other Liabilities	3,187,584	(12,317,041)	13,045,660
Net Cash Provided by Operating Activities	20,831,140	57,868,886	20,347,119
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from Maturities of Securities Held to Maturity	-	2,515,000	2,030,000
Purchases of Securities Held to Maturity	-	(11,317,961)	(4,055,244)
Proceeds from Sales of Securities Available for Sale	85,549,348	3,623,307	2,511,555
Proceeds from Maturities of Securities Available for Sale	21,516,171	39,279,488	76,493,279
Purchases of Securities Available for Sale	(18,390,551)	(56,328,450)	(63,168,007)
Net Increase in Loans	(88,094,271)	(144,620,680)	(97,716,944)
Cash Paid for Business Combinations	(10,842,869)	(1,882,052)	(6,403,091)
Purchases of Bank Premises and Equipment	(2,101,021)	(3,817,897)	(2,239,642)
Proceeds from Sales of Bank Premises and Equipment	3,260	20,886	8,317
Proceeds from Sales of Foreclosed Assets	3,341,029	6,350,569	4,051,258
Net Cash Used by Investing Activities	(9,018,904)	(166,177,790)	(88,488,519)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net Increase (Decrease) in Deposits	(36,358,696)	66,853,748	130,639,659
Net Increase (Decrease) in Short-Term Borrowings	2,657,386	(4,728,651)	6,408,985
Repayments of Notes Payable	(135,811)	(125,640)	(115,669)
Cash Dividends Paid on Preferred Stock	(200,000)	(200,000)	(339,444)
Cash Dividends Paid on Common Stock	(5,332,107)	(4,688,642)	(4,266,038)
Tax Benefits on Stock Plans	538,637	266,992	349,454
Redemption of Common stock	-	(203,211)	-
Net Cash Provided (Used) by Financing Activities	(38,830,591)	57,174,596	132,676,947
NET CHANGE IN CASH AND CASH EQUIVALENTS	(27,018,355)	(51,134,308)	64,535,547
Cash and Cash Equivalents at Beginning of Year	72,544,442	123,678,750	59,143,203
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 45,526,087	$ 72,544,442	$ 123,678,750

See accompanying Notes to Consolidated Financial Statements.

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2014, 2013 AND 2012

	2014	2013	2012
SUPPLEMENTAL SCHEDULE OF NONCASH ACTIVITIES			
Loan Collateral Transferred to Foreclosed Assets	$ 1,499,009	$ 1,370,763	$ 1,810,940
Issuance of Restricted Shares	1,548,881	1,892,199	1,399,103
Unrealized Gain/(Loss) on Securities Available for Sale	1,161,063	(4,644,863)	1,071,651
INTEREST PAID FOR THE PERIOD	3,394,904	3,880,920	4,967,168
INCOME TAX PAYMENTS FOR THE PERIOD	11,257,219	15,127,506	12,718,743
ACQUISITIONS			
Noncash Assets Acquired	127,649,837	1,882,052	7,367,614
Liabilities Assumed	(116,806,968)	-	(964,524)
Net Noncash Asset Acquired	10,842,869	1,882,052	6,403,090
Cash and Cash Equivalents Acquired	17,690,175	-	150,108
Net Gain Recorded on Acquisitions	$ -	$ -	$ -

See accompanying Notes to Consolidated Financial Statements.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Alerus Financial Corporation (Company) is a financial holding company organized under the laws of Delaware. The Company, through its subsidiaries, engages primarily in general commercial banking, mortgage banking, and trust services. The Company's subsidiary operations also include discount brokerage services, retail multi-peril crop insurance sales, and investment advisement services.

Policies which materially affect the determination of financial position, cash flows, and results of operations are summarized below.

The subsidiary Bank operates under a national charter and provides full banking services. As a national bank, the Bank is subject to regulation by the Office of Comptroller of Currency and the Federal Deposit Insurance Company.

Principles of Consolidation

The consolidated financial statements include the amounts of Alerus Financial Corporation and its wholly-owned subsidiaries: Alerus Financial, N.A. (Bank), Alerus Securities Corporation, Alerus Insurance Services, and Alerus Investment Advisors. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term include the classification and valuation of securities, determination of the allowance for loan losses, valuation of reporting units for the purpose of testing goodwill for impairment, valuation of investments, fair value of assets acquired and liabilities assumed upon completion of a business combination, valuation of deferred tax assets, and fair values of financial instruments.

New Accounting Pronouncements

In 2014, the Company adopted Accounting Standards Update (ASU) 2013-02, *Comprehensive Income (Topic 220)*. ASU 2013-02 amended prior guidance to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income if the amount reclassified is required under U.S. GAAP. The adoption of ASU 2013-02 did not impact the Company's financial position or results of operations.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Concentrations of Credit Risk

Most of the Company's activities are with customers located within the North Dakota, northwestern Minnesota and the Minneapolis/St. Paul, Minnesota metropolitan area. Note 3 discusses the types of securities that the Company invests in. Note 4 discusses the types of lending that the Company engages in. The Company does not have any significant concentrations in any one industry or customer.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold, and securities purchased under agreements to resell, all of which have an original maturity within 90 days. Cash flows from loans and deposits are reported net.

Interest Bearing Deposits in Banks

Interest-bearing deposits in banks mature within one year and are carried at cost.

Securities

Debt securities that are held for short-term resale are classified as trading securities and carried at fair value. Debt securities that management has the ability and intent to hold to maturity are classified as held to maturity and carried at cost, adjusted for amortization of premium and accretion of discounts computed primarily by the interest method. Other marketable securities are classified as available for sale and are carried at fair value. Realized gains and losses on securities available for sale are included in other income or expense and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Gains and losses on sales of securities are determined using the specific identification method on the trade date. The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the period to maturity.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. The Company monitors the investment security portfolio for impairment on an individual security basis and has a process in place to identify securities that could potentially have a credit impairment that is other than temporary. This process involves analyzing the length of time and the extent to which the fair value has been less than the amortized cost basis, the market liquidity for the security, the financial condition and near-term prospects of the issuer, expected cash flows, and the Company's intent and ability to hold the investment for a period of time sufficient to recover the temporary loss. The ability to hold is determined whether it is more likely than not that the Company will be required to sell the security before its anticipated recovery. A decline in value due to a credit event that is considered other than temporary is recorded as a loss in noninterest income.

Equity investments for which quoted market values are unavailable are carried at cost in Other Assets on the consolidated balance sheets.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Securities (Continued)

The Company has investments in certain entities for which the Company does not have the controlling interest. For these investments, the Company records its interest using the equity method with its portion of income or loss being recorded in Noninterest Income in the consolidated statements of income. The Company periodically evaluates these investments for impairment.

Derivatives and Hedging Activities

All derivatives are recognized on the balance sheet at their fair value. On the date the derivative contract is entered into, the Company designates the derivative as (1) a hedge of fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), or (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge), or (3) held for trading, customer accommodation or asset/liability risk management purposes, including economic hedges not qualifying for hedge accounting. Changes in the fair value of a derivative that is highly effective - and that is designated and qualifies - as a fair value hedge, along with the loss or gain on the hedged asset or liability that is attributable to the hedged risk (including losses or gains on firm commitments), are recorded in current-period earnings. Changes in the fair value of a derivative that is highly effective as - and that is designated and qualifies as - a cash-flow hedge are recorded in other comprehensive income, until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable rate asset or liability are recorded in earnings).

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as cash-flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively. When management discontinues hedge accounting because a derivative no longer qualifies as an effective fair value hedge, management continues to carry the derivative in the balance sheet at its fair value with changes in fair value included in earnings, and no longer adjust the previously hedged asset or liability for changes in fair value. Previous adjustments to the hedged item are accounted for in the same manner as other components of the carrying amount of the asset or liability.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Derivatives and Hedging Activities (Continued)

Interest Rate Lock Commitments

The Company enters into rate lock commitments to extend credit to borrowers for generally a 30-day or 60-day period for the origination of mortgage loans. Unfunded loans for which commitments have been entered into are called “pipeline loans.” Some of these rate lock commitments will ultimately expire without being completed. To the extent that a loan is ultimately granted and the borrower ultimately accepts the terms of the loan, these rate lock commitments expose the Company to variability in their fair value due to changes in interest rates. If interest rates increase, the value of these rate lock commitments decreases. Conversely, if interest rates decrease, the value of these rate lock commitments increases.

The Company records the fair value of its rate lock commitments in other assets or liabilities, with changes in fair value recorded in other expenses. Fair value is based on fees currently charged to enter into similar agreements, and for fixed-rate commitments, also considers the difference between current levels of interest rates and the committed rates.

Forward Loan Sale Commitments

To mitigate the effect of this interest rate risk, the Company enters into offsetting forward loan sale commitments. The forward loan sale commitments lock in an interest rate and price for the sale of loans similar to the specific rate lock loan commitments classified as derivatives. Both the rate lock commitments and the forward loan sale commitments are undesignated derivatives, and accordingly are marked to market through earnings.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains and losses on loan sales are recorded in Noninterest Income and direct loan origination costs and fees are deferred at origination of the loan and are recognized in Noninterest Income upon sale of the loan.

Loans

Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, and the allowance for loan losses. Loan fees received that are associated with originating or acquiring certain loans are deferred and amortized over the life of the loan as a yield adjustment to interest income.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loans (Continued)

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans are typically charged off no later than 120 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans Acquired with Deteriorated Credit Quality and Revenue Recognition

The Company has purchased loan portfolios of institutions as a part of business combinations as discussed in notes 2 and 4. The Company accounts for this portfolio of loans using the cost recovery method in accordance with the provisions of ASC 310-30.

The Company follows specific accounting guidance related to purchased impaired loans that have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. Evidence of credit quality deterioration as of the purchase date may include statistics such as past due status. The accounting guidance permits the use of the cost recovery method of income recognition for those purchased impaired loans for which the timing and amount of cash flows expected to be collected cannot be reasonably estimated. Under the cost recovery method of income recognition, all cash receipts are initially applied to principal, with interest income being recorded only after the carrying value of the loans has been reduced to zero.

For loans acquired as a part of the failed bank acquisition, the portfolio purchase agreement contains representations and warranties that allow the Company to require the FDIC to repurchase the non-qualifying loans within a specified period of time. Typical reasons for repurchase include death, bankruptcy discharge, or prior settlement. Repurchases are accounted for as an adjustment to the purchase price and not as loan collections.

Sales of individual loans within loan portfolios are accounted for in accordance with the revenue recognition method described above. Gains on bulk sales or groups of loans, representing the difference between the sales price and the basis of the loans, are recognized when the loans are sold. Bulk sales can result in impairment entries in some cases, since the remaining estimated future cash flow is significantly affected by the sale. As discussed above, the portfolio basis must be written down in these situations to maintain a constant yield over the portfolio’s remaining life.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses

The allowance for loan losses (allowance) is an estimate of loan losses inherent in the Company's loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after loan losses and loan growth. Loan losses are charged off against the allowance when the Company determines the loan balance to be uncollectible. Cash received on previously charged off amounts is recorded as a recovery to the allowance.

The allowance consists of three primary components, general reserves specific reserves related to impaired loans, and unallocated reserves. The general component covers non-impaired loans and is based on historical losses adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent five years. The Company places more emphasis, or weight, on the more current quarters in the loss history period. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the original contractual interest rate, except that as a practical expedient, it may measure impairment based on an observable market price, or the fair value of the collateral if collateral dependent. A loan is collateral dependent if the repayment is expected to be provided solely by the underlying collateral.

Allowance allocations other than general and specific are included in the unallocated portion. While allocations are made for loans based upon historical loss analysis, the unallocated portion is designed to cover the uncertainty of how current economic conditions and other uncertainties may impact the existing loan portfolio. Factors to consider include national and state economic conditions such as increases in unemployment and the real estate lending crisis. The unallocated reserve addresses inherent probable losses not included elsewhere in the allowance for loan losses.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses (Continued)

Under certain circumstances, the Company will provide borrowers relief through loan restructurings. A restructuring of debt constitutes a troubled debt restructuring (TDR) if the Company for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above in the calendar year of the restructuring. In subsequent years, a restructured loan may cease being classified as impaired if the loan was modified at a market rate and is performing according to the modified terms. TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal or interest due, or acceptance of other assets in full or partial satisfaction of the debt. Restructured loans can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. Nonaccrual restructured loans are included and treated with other nonaccrual loans.

The Company assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed internal reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by the Company's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which the borrowers operate and the fair values of collateral securing the loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

Pass: A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, this potential weakness may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date. Special mention loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard: Loans classified as substandard are not adequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Well-defined weaknesses include a borrower's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses (Continued)

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss: Loans classified as loss are considered uncollectible and charged off immediately.

The Company maintains a separate general valuation allowance for each portfolio segment. These portfolio segments include commercial, industrial, and agricultural, real estate construction, commercial and agricultural real estate, real estate mortgage 1-4 family first mortgage and junior mortgage, and other revolving and installment with risk characteristics described as follows:

Commercial, Industrial, and Agricultural: Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments as these loans are generally underwritten based on the cash flows of the operating business. Repayment is provided by business cash flows. Repayment is influenced by economic trends such as unemployment rates and other key economic factors. Agricultural loans generally possess a lower inherent risk of loss than real estate portfolio segments for the same reasons as commercial and industrial loans. However, they generally possess greater volatility of risk due commodity pricing, which can lead to cash flow and collateral shortfalls.

Real Estate Construction: Real estate construction loans generally possess a higher inherent risk of loss than commercial and retail real estate portfolio segments. Significant inherent risks are project completion, cost overruns, and adherence to construction schedule. Additionally, real estate values could significantly impact the credit quality of these loans.

Commercial and Agricultural Real Estate: Commercial real estate loans generally possess a higher inherent risk of loss than retail real estate portfolio segments, except real estate construction and agricultural land loans. Adverse economic developments such as high vacancy rates or decreasing real estate values may impact commercial real estate credit quality. Agricultural real estate loans are primarily comprised of loans for the purchase of farmland. Risks associated with farmland include volatility of real estate values driven by commodity prices, among other economic trends.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Loan Losses (Continued)

Real Estate Mortgage 1-4 Family First Mortgage and Junior Mortgage: The degree of risk in residential mortgage lending depends primarily on the loan amount in relation to collateral value, the interest rate, and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than commercial real estate portfolio segments. Credit quality is impacted by unemployment rates and other key economic indicators.

Other Revolving and Installment: The consumer loan portfolio is primarily comprised of homogenous loans. Credit quality is impacted by unemployment rates and other key economic indicators.

Although management believes the allowance to be adequate, actual losses may vary from its estimates. On a quarterly basis, the board of directors reviews the adequacy of the allowance, including consideration of the relevant risks in the portfolio, current economic conditions and other factors. If the board of directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulator assesses the adequacy of the allowance. The regulatory agencies may require adjustments to the allowance based on their judgment about information available at the time of their examinations.

Off-Balance-Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under credit arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded. Management estimates anticipated losses using historical data and utilization assumptions.

Premises and Equipment

Land is carried at cost. Other premises and equipment are carried at cost net of accumulated depreciation. Depreciation is computed on the straight-line method based principally on the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Bank Owned Life Insurance

The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at its cash surrender value, or the amount that can be realized, if lower.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of Long-Lived Assets

The Company tests long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or fair value less estimated costs to sell.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less estimated selling cost at the date of foreclosure, establishing a new cost basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets held for sale are carried at the lower of the new cost basis or fair value less cost to sell. This evaluation is inherently subjective and requires estimates that are susceptible to significant revisions as more information becomes available. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values will occur in the near term and that such changes could materially affect the amounts reported in the Company's consolidated financial statements.

Impairment losses on assets to be held and used are measured at the amount by which the carrying amount of a property exceeds its fair value. Costs of significant asset improvements are capitalized, whereas costs relating to holding assets are expensed. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

Goodwill and Other Intangibles

Goodwill resulting from acquisitions is not amortized, but is tested for impairment annually. As part of its testing, the Company first assesses the qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the Company determines the fair value of a reporting unit is less than its carrying amount using these qualitative factors, the Company then compares the fair value of the goodwill with its carrying amount, and then measures impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions, and selecting an appropriate control premium. At December 31, 2014, the Company believes the Bank Subsidiary does not have any indicators of potential impairment based on the estimated fair value of this reporting unit.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Goodwill and Other Intangibles (Continued)

Intangible assets determined to have definite lives are amortized over the remaining useful lives. Intangible and other long-lived assets are reviewed for impairment whenever events occur or circumstances indicate that the carrying amount may not be recoverable.

Servicing Rights

Servicing rights are recognized as separate assets when rights are acquired through sale of mortgage loans. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future servicing income of the underlying loans.

Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan, and are recorded as income when earned. The amortization of servicing rights is netted against loan servicing fee income.

Transfers of Financial Assets and Participating Interests

Transfers of an entire financial asset or a participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Transfers of Financial Assets and Participating Interests (Continued)

The transfer of a participating interest in an entire financial asset must also meet the definition of a participating interest. A participating interest in a financial asset has all of the following characteristics: (1) from the date of transfer, it must represent a proportionate (pro rata) ownership interest in the financial asset, (2) from the date of transfer, all cash flows received, except any cash flows allocated as any compensation for servicing or other services performed, must be divided proportionately among participating interest holders in the amount equal to their share ownership, (3) the rights of each participating interest holder must have the same priority, (4) no party has the right to pledge or exchange the entire financial asset unless all participating interest holders agree to do so.

Advertising Costs

Advertising costs are expensed as incurred.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal and state income tax laws, and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax liabilities.

Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is “more likely than not” that the deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management’s evaluation of both positive and negative evidence, the forecasts of future income, applicable tax planning strategies, and assessments of the current and future economic and business conditions.

The Company follows standards related to Accounting for Uncertainty in Income Taxes. These rules establish a higher standard for tax benefits to meet before they can be recognized in a Company’s consolidated financial statements. The Company can recognize in financial statements the impact of a tax position taken, or expected to be taken, if it is more likely than not that the position will be sustained on audit based on the technical merit of the position. See Note 20, Income Taxes, for additional disclosures. The Company recognizes both interest and penalties as components of other operating expenses.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income Taxes (Continued)

The amount of the uncertain tax position was not determined to be material. It is not expected that the unrecognized tax benefit will be material within the next 12 months. The Company did not recognize any interest or penalties in 2014 or 2013.

The Company files consolidated federal and state income tax returns and it is not subject to federal and state income tax examinations for taxable years prior to 2011.

Comprehensive Income

Recognized revenue, expenses, gains, and losses are included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income.

Stock Compensation Plans

Stock compensation accounting guidance requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. The cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employee's service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The market price of the Company's common stock at the date of grant is used for restricted stock awards.

All share data contained within the financial statements has been retroactively restated for stock based transactions (i.e. stock splits effected in the form of dividends).

Earnings Per Share

Earnings per share amounts are computed by dividing the net income for the period by the weighted average number of shares of common stock outstanding during the period. The assumed exercise of outstanding stock options would not have a materially dilutive effect. Net income per share has been retroactively adjusted for all stock splits effected in the form of dividends.

Reclassification

Certain amounts have been reclassified in prior years to conform to the current period presentation.

NOTE 2 BUSINESS COMBINATIONS

On February 1, 2012, the Company acquired select assets and liabilities of PensionTrend, Inc. and Pension Trend Investment Advisors, LLC located in Okemos, Troy, and Marquette, Michigan. The purchased assets and assumed liabilities were recorded at their respective acquisition date fair values, and identified intangible assets were recorded at fair value. The purchase, consisting of 230 retirement plans with more than 23,000 retirement participants, grew the Company's wealth management division by $750 million in retirement and individual asset managed accounts. As part of the transaction, the Company allocated $7,040,482 to an identified customer intangible.

On September 30, 2013, the Company acquired select assets and liabilities of Tegrit Administrators, LLC located in Spartanburg, Ohio. The purchased assets and assumed liabilities were recorded at their respective acquisition date fair values, and identified intangible assets were recorded at fair value. The purchase, consisting of approximately 1,875 retirement plans with more than 30,000 retirement participants, grew the Company's wealth management division by $1.3 billion in retirement and individual asset managed accounts. As part of the transaction, the Company allocated $1,882,052 to an identified customer intangible.

On June 25, 2014, the Company acquired Private Bancorporation, Inc. (PBI). with one location located in downtown Minneapolis. The purchased assets and assumed liabilities were recorded at their respective acquisition date fair values as follows:

Assets	As Recorded by PBI	Fair Value Adjustments	As Recorded by Alerus
Cash and Cash Equivalents	$ 17,458,168	$ -	$ 17,458,168
Securities	12,442,761	15,414	12,458,175
Regulatory Stock	-	-	-
Loans	99,144,938	(5,471,859)	93,673,079
Premises and Equipment	106,774	(56,774)	50,000
Foreclosed Assets	1,758,205	90,000	1,848,205
Accrued Interest Receivable	282,596	-	282,596
Core Deposit Intangible	-	1,200,000	1,200,000
Deferred Tax Asset	1,241,142	2,695,189	3,936,331
Other Assets	408,511	23,001	431,512
Total Assets	132,843,095	(1,505,029)	131,338,066
Liabilities			
Deposits	115,923,452	-	115,923,452
Other Liabilities	324,770	76,000	400,770
Total Liabilities	116,248,222	76,000	116,324,222
Excess of Assets Over Liabilities	$ 16,594,873	$ (1,581,029)	15,013,844
Cash Paid for PBI			15,865,643
Total Goodwill Recorded			$ 851,799

NOTE 2 BUSINESS COMBINATIONS (CONTINUED)

As part of the PBI acquisition, impaired loans on the date of acquisition were transferred into a separate LLC. The outstanding principal of these loans was $8,762,488 as of the acquisition date. A discount of $5,077,946 was assigned to these loans, resulting in a fair value of $3,684,542 at the date of acquisition.

On October 1, 2014, the Company acquired Retirement Alliance, Inc. and its affiliate Fiduciary Consulting Group, LLC located in Manchester, NH. The purchased assets and assumed liabilities were recorded at their respective acquisition date fair values, and identified intangible assets were recorded at fair value. The purchase, consisting of approximately 700 retirement plans with more than 42,000 retirement participants, grew the Company's' wealth management division by $2.1 billion in retirement and individual asset managed accounts. As part of the transaction, the Company allocated $12,716,445 to an identified customer intangible.

NOTE 3 INVESTMENT SECURITIES

The amortized cost of securities and their approximate fair values, with gross unrealized gains and losses as of December 31, 2014 and 2013 are as follows:

	2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities:				
U.S. Treasury and Government Agency Securities	$ 90,058,611	$ -	$ (1,560,806)	$ 88,497,805
Obligations of State and Political Agencies	27,153,347	871,369	(54,271)	27,970,445
Mortgage Backed Securities:				
Residential Agency	78,431,402	2,985,752	(10,050)	81,407,104
Commercial	1,268,550	40,543	-	1,309,093
Equity Securities	5,072,405	-	(115,589)	4,956,816
Total	$ 201,984,315	$ 3,897,664	$ (1,740,716)	$ 204,141,263

NOTE 3 INVESTMENT SECURITIES (CONTINUED)

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities:				
U.S. Treasury and Government Agency Securities	$ 90,086,672	$ -	$ (4,858,212)	$ 85,228,460
Corporate Debt Securities	37,742,119	1,293,180	(95,020)	38,940,279
Mortgage Backed Securities:				
Residential Agency	87,913,072	3,943,061	(6)	91,856,127
Commercial	1,960,014	69,331	-	2,029,345
Other Debt Securities	80,233	3,544	(1)	83,776
Equity Securities	4,768,870	-	(27,376)	4,741,494
Total	$ 222,550,980	$ 5,309,116	$ (4,980,615)	$ 222,879,481
Held-to-Maturity Securities:				
Obligations of State and Political Agencies	$ 29,155,340	$ 476,592	$ (471,746)	$ 29,160,186
Corporate Debt Securities	25,736,775	996,113	-	26,732,888
Total	$ 54,892,115	$ 1,472,705	$ (471,746)	$ 55,893,074

The amortized cost and approximate fair value of securities as of December 31, 2014, by contractual maturity, are as follows:

	Securities Available for Sale	
December 31, 2014	Amortized Cost	Approximate Market Value
Due in One Year or Less	$ 6,377,801	$ 6,292,310
Due After One Year through Five Years	89,108,710	91,305,479
Due After Five Years through Ten Years	78,413,660	78,295,005
Due After Ten Years	28,084,144	28,248,469
Total	$ 201,984,315	$ 204,141,263

Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

NOTE 3 INVESTMENT SECURITIES (CONTINUED)

Securities with a carrying value of $144,051,195 and $162,936,251 were pledged at December 31, 2014 and 2013, respectively, to secure public deposits, repurchase agreements, and for other purposes required or permitted by law. Included in these amounts were securities sold under agreements which were collateralized by securities with a carrying amount of $19,583,940 at December 31, 2014 and $18,811,560 at December 31, 2013.

Proceeds from the sale of available-for-sale securities for the years ended December 31, 2014, 2013, and 2012 were $85,549,348, $3,623,307, and $2,511,555, respectively. Gross losses recognized on these sales were $32,801, $28,069, and $3,816 for the years ended December 31, 2014, 2013, and 2012, respectively. Gross gains recognized on these sales were $2,162,914, $84,101, and $220,674 for the years ended December 31, 2014, 2013, and 2012, respectively.

Proceeds from the sale and maturity of trading securities for the years ended December 31, 2014, 2013, and 2012 were $527,389, $224,490, and $447,805, respectively. For the years ended December 31, 2014, 2013, and 2012, gross losses recognized on these sales and maturities were $3,447, $1,922, and $1,279, respectively. For the years ended December 31, 2014, 2013, and 2012, gross gains recognized on these were $401, $-0-, and $1,509, respectively.

During 2014, the Company transferred all held-to-maturity securities to available-for-sale securities. At the time of transfer the book value of the securities was $53,739,487. The unrealized gain of $1,943,537 was recorded immediately in other comprehensive income. The transaction was the result of a strategic decision by the Company to liquidate its corporate bond portfolio which comprised 51.4% of the held-to-maturity portfolio.

Information pertaining to securities with gross unrealized losses that are not deemed to be other-than-temporarily impaired at December 31, 2014 and 2013 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less than 12 Months		Over 12 Months		Total	
December 31, 2014	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities Available for Sale:						
U.S. Government and Federal Agency	$ (60,194)	$ 20,007,530	$ (1,500,612)	$ 68,490,275	$ (1,560,806)	$ 88,497,805
Obligations of State and Political Agencies	(25,345)	2,470,050	(28,926)	2,562,270	(54,271)	5,032,320
Mortgage Backed Securities:						
Residential Agency	(10,050)	7,925,042	-	-	(10,050)	7,925,042
Equity Securities	-	-	(115,589)	2,321,513	(115,589)	2,321,513
Total Securities Available for Sale	$ (95,589)	$ 30,402,622	$ (1,645,127)	$ 73,374,058	$ (1,740,716)	$ 103,776,680

NOTE 3 INVESTMENT SECURITIES (CONTINUED)

December 31, 2013	Less than 12 Months Gross Unrealized Losses	Less than 12 Months Fair Value	Over 12 Months Gross Unrealized Losses	Over 12 Months Fair Value	Total Gross Unrealized Losses	Total Fair Value
Securities Available for Sale:						
Debt Securities:						
U.S. Government and Federal Agency	$ (4,267,122)	$ 75,819,550	$ (591,090)	$ 9,408,910	$ (4,858,212)	$ 85,228,460
Corporate Debt Securities	(95,020)	16,119,990	-	-	(95,020)	16,119,990
Mortgage Backed Securities:						
Residential Agency	(6)	1,353	-	-	(6)	1,353
Other Debt Securities	-	-	(1)	1,071	(1)	1,071
Equity Securities	(27,376)	2,409,727	-	-	(27,376)	2,409,727
Total Securities Available for Sale	$ (4,389,524)	$ 94,350,620	$ (591,091)	$ 9,409,981	$ (4,980,615)	$ 103,760,601
Securities Held to Maturity:						
Obligations of State and Political Agencies	$ (410,821)	$ 9,312,598	$ (60,925)	$ 1,030,770	$ (471,746)	$ 10,343,368

At December 31, 2014 all of the available-for-sale debt securities in an unrealized loss position were investment grade. During the year ended December 31, 2014, the Company evaluated all of its debt securities for credit impairment and determined there were no credit losses evident and did not record any other-than-temporary impairment. As of December 31, 2014, the Company's evaluation of other securities with continuous unrealized losses indicated that there were no credit losses evident. Furthermore, the Company does not intend to sell and it is more likely than not that the Company will not be required to sell these debt securities before the anticipated recovery of the amortized cost basis.

The Company conducts periodic reviews to identify and evaluate each investment that has an unrealized loss for other-than-temporary impairment. An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. Unrealized losses that are determined to be temporary in nature are recorded, net of tax, in accumulated other comprehensive income for available-for-sale securities.

NOTE 4 LOANS

As discussed in Note 2, the Company acquired substantially all of the assets and liabilities of PBI in the current year. The loans and foreclosed assets acquired in a failed bank transaction during 2009 were covered by loss share agreements between the FDIC and Alerus Financial, N.A. As of December 31, 2014, the commercial loss share agreement expired. The single family loss share agreement is in effect until 2019. The risk of the acquired single family loans and foreclosed assets are significantly different from those assets not covered under the loss share agreements. The Company has applied ASC 310-30 to all impaired loans purchased as a part of FDIC purchase and assumption agreements.

NOTE 4 LOANS (CONTINUED)

The components of covered and non-covered loans in the consolidated balance sheets were as follows:

	December 31, 2014		
	Covered	Noncovered	Total Loans
Commercial:			
Commercial, Industrial and Agricultural	$ -	$ 394,297,981	$ 394,297,981
Real Estate Construction	-	20,544,250	20,544,250
Commercial and Agricultural Real Estate	-	270,313,785	270,313,785
Other	-	5,469,545	5,469,545
Total Commercial	-	690,625,561	690,625,561
Consumer:			
Real Estate 1-4 Family First Mortgage	859,323	166,317,743	167,177,066
Real Estate 1-4 Family Junior Mortgage	2,283,962	155,636,561	157,920,523
Other Revolving and Installment	2,288,448	77,446,711	79,735,159
Total Consumer	5,431,733	399,401,015	404,832,748
Total Loans	5,431,733	1,090,026,576	1,095,458,309
Less: Allowance for Loan Losses	(43,454)	(17,020,043)	(17,063,497)
Net Loans	$ 5,388,279	$ 1,073,006,533	$ 1,078,394,812

	December 31, 2013		
	Covered	Noncovered	Total Loans
Commercial:			
Commercial, Industrial and Agricultural	$ 798,657	$ 378,089,711	$ 378,888,368
Real Estate Construction	10,496	3,280,030	3,290,526
Commercial and Agricultural Real Estate	11,635,342	248,046,900	259,682,242
Other	24,660	3,512,784	3,537,444
Total Commercial	12,469,155	632,929,425	645,398,580
Consumer:			
Real Estate 1-4 Family First Mortgage	1,869,527	111,782,678	113,652,205
Real Estate 1-4 Family Junior Mortgage	5,584,899	89,763,541	95,348,440
Other Revolving and Installment	97,757	60,067,614	60,165,371
Total Consumer	7,552,183	261,613,833	269,166,016
Total Loans	20,021,338	894,543,258	914,564,596
Less: Allowance for Loan Losses	(668,260)	(16,169,865)	(16,838,125)
Net Loans	$ 19,353,078	$ 878,373,393	$ 897,726,471

NOTE 4 LOANS (CONTINUED)

Changes in the allowance for years ended December 31, 2014 and 2013 are summarized in the following table:

	2014	2013
Balance - Beginning of Period	$ 16,838,125	$ 15,101,098
Provision for Loan Losses	(400,000)	1,200,000
Loan Charge-Offs:		
Commercial:		
Commercial, Industrial and Agricultural	(312,231)	(513,664)
Real Estate Construction	(4,020)	-
Commercial and Agricultural Real Estate	(78,846)	(16,254)
Other	(169,073)	(24,466)
Total Commercial	(564,170)	(554,384)
Consumer:		
Real Estate 1-4 Family First Mortgage	(881)	(11,035)
Real Estate 1-4 Family Junior Mortgage	(267,359)	(146,125)
Other Revolving and Installment	(188,071)	(373,741)
Total Consumer	(456,311)	(530,901)
Total Loan Charge-Offs	(1,020,481)	(1,085,285)
Loan Recoveries:		
Commercial:		
Commercial, Industrial and Agricultural	952,332	1,193,225
Real Estate Construction	128,106	199,753
Commercial and Agricultural Real Estate	200,725	75,081
Other	36,166	13,037
Total Commercial	1,317,329	1,481,096
Consumer:		
Real Estate 1-4 Family First Mortgage	70,041	5,716
Real Estate 1-4 Family Junior Mortgage	113,496	36,103
Other Revolving and Installment	144,987	99,397
Total Consumer	328,524	141,216
Total Loan Recoveries	1,645,853	1,622,312
Net Loan (Charge-Offs) / Recoveries	625,372	537,027
Balance - End of Period	$ 17,063,497	$ 16,838,125

NOTE 4 LOANS (CONTINUED)

The following tables summarize the activity in the allowance for loan losses by commercial and consumer portfolio segments for years ended December 31, 2014 and 2013:

2014	Commercial	Consumer	Unallocated	Total
Balance - Beginning of Period	$ 12,910,076	$ 2,001,263	$ 1,926,786	$ 16,838,125
Provision for Loan Losses	(106,527)	887,375	(1,180,848)	(400,000)
Total	12,803,549	2,888,638	745,938	16,438,125
Loan Charge-Offs	(564,170)	(456,311)	-	(1,020,481)
Loan Recoveries	1,317,329	328,524	-	1,645,853
Net Recoveries (Charge-Offs)	753,159	(127,787)	-	625,372
Balance - End of Period	$ 13,556,708	$ 2,760,851	$ 745,938	$ 17,063,497

2013	Commercial	Consumer	Unallocated	Total
Balance - Beginning of Period	$ 11,955,596	$ 1,718,637	$ 1,426,865	$ 15,101,098
Provision for Loan Losses	27,768	672,311	499,921	1,200,000
Total	11,983,364	2,390,948	1,926,786	16,301,098
Loan Charge-Offs	(554,384)	(530,901)	-	(1,085,285)
Loan Recoveries	1,481,096	141,216	-	1,622,312
Net Recoveries (Charge-Offs)	926,712	(389,685)	-	537,027
Balance - End of Period	$ 12,910,076	$ 2,001,263	$ 1,926,786	$ 16,838,125

The following tables disaggregate the allowance and recorded investment in loans by impairment methodology:

	Allowance for Loan Losses				Recorded Investment in Loans		
December 31, 2014	Commercial	Consumer	Unallocated	Total	Commercial	Consumer	Total
Collectively Evaluated	$ 13,492,137	$ 2,747,962	$ 745,938	$ 16,986,037	$ 687,714,518	$ 404,389,673	$ 1,092,104,191
Individually Evaluated	64,571	12,889	-	77,460	2,862,668	34,659	2,897,327
Purchased Credit Impaired	-	-	-	-	48,375	408,416	456,791
Total	$ 13,556,708	$ 2,760,851	$ 745,938	$ 17,063,497	$ 690,625,561	$ 404,832,748	$ 1,095,458,309

	Allowance for Loan Losses				Recorded Investment in Loans		
December 31, 2013	Commercial	Consumer	Unallocated	Total	Commercial	Consumer	Total
Collectively Evaluated	$ 12,795,186	$ 2,001,263	$ 1,926,786	$ 16,723,235	$ 644,151,348	$ 269,136,888	$ 913,288,236
Individually Evaluated	114,890	-	-	114,890	1,247,232	9,300	1,256,532
Purchased Credit Impaired	-	-	-	-	-	19,828	19,828
Total	$ 12,910,076	$ 2,001,263	$ 1,926,786	$ 16,838,125	$ 645,398,580	$ 269,166,016	$ 914,564,596

NOTE 4 LOANS (CONTINUED)

The tables below provide a breakdown of outstanding commercial loans by risk category as of December 31, 2014 and 2013. It also details the effect of the 80% FDIC indemnification on covered loans. All criticized loans are subject to high levels of monitoring by management. The Criticized category includes Special Mention, Substandard and Doubtful categories which are defined by banking regulatory agencies. This information is tracked and assessed separately for covered loans and non-covered loans

December 31, 2014	Commercial, Industrial and Ag	Commercial and Agricultural Real Estate	Real Estate Construction	Other	Total
Noncovered Portfolio					
By Risk Category:					
Pass	$ 374,348,306	$ 244,553,695	$ 20,212,696	$ 5,131,709	$ 644,246,406
Criticized	19,949,675	25,760,090	331,554	337,836	46,379,155
Total Commercial Loans	$ 394,297,981	$ 270,313,785	$ 20,544,250	$ 5,469,545	$ 690,625,561

December 31, 2013	Commercial, Industrial and Ag	Commercial and Agricultural Real Estate	Real Estate Construction	Other	Total
Noncovered Portfolio					
By Risk Category:					
Pass	$ 360,123,349	$ 222,331,809	$ 3,280,030	$ 3,166,918	$ 588,902,106
Criticized	17,966,362	25,715,091	-	345,866	44,027,319
Total Commercial Loans	$ 378,089,711	$ 248,046,900	$ 3,280,030	$ 3,512,784	$ 632,929,425
Covered Portfolio					
By Risk Category:					
Pass	$ 621,128	$ 8,982,618	$ -	$ 24,660	$ 9,628,406
Criticized	177,529	2,652,724	10,496	-	2,840,749
Total Commercial Loans	$ 798,657	$ 11,635,342	$ 10,496	$ 24,660	$ 12,469,155
Loans At Risk Net 80% FDIC Coverage	$ 159,731	$ 2,327,068	$ 2,099	$ 4,932	$ 2,493,830

NOTE 4 LOANS (CONTINUED)

The following tables reflect the past due aging analysis of the loan portfolio as of December 31, 2014 and 2013:

December 31, 2014	30-89 Days Past Due	90+ Days Past Due Still Accruing	Nonaccrual Loans	Current	Total Loans
Noncovered Loans					
Commercial:					
Commercial, Industrial and Agricultural	$ 220,558	$ -	$ 572,468	$ 393,504,955	$ 394,297,981
Real Estate Construction	-	-	-	20,544,250	20,544,250
Commercial and Agricultural Real Estate	31,512	-	1,844,202	268,438,071	270,313,785
Other	-	-	-	5,469,545	5,469,545
Total Commercial	252,070	-	2,416,670	687,956,821	690,625,561
Consumer:					
Real Estate 1-4 Family First Mortgage	943,093	5,170	139,402	165,230,078	166,317,743
Real Estate 1-4 Family Junior Mortgage	248,622	386,667	1,028,333	153,972,939	155,636,561
Other Revolving and Installment	256,862	-	20,108	77,169,741	77,446,711
Total Consumer	1,448,577	391,837	1,187,843	396,372,758	399,401,015
Total Noncovered Loans	1,700,647	391,837	3,604,513	1,084,329,579	1,090,026,576
Covered Loans	174,599	-	-	5,257,134	5,431,733
Total Loans	$ 1,875,246	$ 391,837	$ 3,604,513	$ 1,089,586,713	$ 1,095,458,309

December 31, 2013	30-89 Days Past Due	90+ Days Past Due Still Accruing	Nonaccrual Loans	Current	Total Loans
Noncovered Loans					
Commercial:					
Commercial, Industrial and Agricultural	$ 410,839	$ -	$ 1,317,156	$ 376,361,716	$ 378,089,711
Real Estate Construction	-	-	-	3,280,030	3,280,030
Commercial and Agricultural Real Estate	-	-	241,559	247,805,341	248,046,900
Other	-	-	-	3,512,784	3,512,784
Total Commercial	410,839	-	1,558,715	630,959,871	632,929,425
Consumer:					
Real Estate 1-4 Family First Mortgage	175,865	-	46,722	111,560,091	111,782,678
Real Estate 1-4 Family Junior Mortgage	219,100	-	221,392	89,323,049	89,763,541
Other Revolving and Installment	488,087	-	9,300	59,570,227	60,067,614
Total Consumer	883,052	-	277,414	260,453,367	261,613,833
Total Noncovered Loans	1,293,891	-	1,836,129	891,413,238	894,543,258
Covered Loans	546	-	3,540,761	16,480,031	20,021,338
Total Loans	$ 1,294,437	$ -	$ 5,376,890	$ 907,893,269	$ 914,564,596

Interest income foregone on nonaccrual loans approximated $281,347 and $396,716 for the years ended December 31, 2014 and 2013, respectively.

NOTE 4 LOANS (CONTINUED)

The tables below summarize key information for impaired loans. These impaired loans may have estimated loss which is included in the allowance for loan losses. Impaired loans exclude loans covered under the FDIC shared loss agreement.

	December 31, 2014		
	Unpaid Principal	Recorded Investment	Related Allowance
Commercial, Industrial and Agricultural	$ 2,143,470	$ 1,776,670	$ 64,571
Real Estate Construction	-	-	-
Commercial and Agricultural Real Estate	367,907	290,973	-
1-4 Family 1st Mortgage	262,452	258,983	-
1-4 Family Junior Mortgage	598,391	536,042	-
Other Revolving and Installment	91,766	34,659	12,889
Total Impaired Loans at December 31, 2014	$ 3,463,986	$ 2,897,327	$ 77,460

	December 31, 2013		
	Unpaid Principal	Recorded Investment	Related Allowance
Commercial, Industrial and Agricultural	$ 918,294	$ 918,294	$ 41,368
Commercial and Agricultural Real Estate	328,938	328,938	73,522
Other	-	-	-
Other Revolving and Installment	29,128	29,128	-
Total Impaired Loans at December 31, 2013	$ 1,276,360	$ 1,276,360	$ 114,890

The table below presents the average recorded investment in impaired loans and interest income for years ended December 31, 2014 and 2013, respectively. No Interest income on impaired loans was recognized using the cash basis of accounting during the years ended December 31, 2014 and 2013.

	2014		2013	
	Average Recorded Investments	Interest Income	Average Recorded Investments	Interest Income
Commercial:				
Commercial, Industrial and Agricultural	$ 946,223	$ 26,738	$ 936,406	$ 56,583
Real Estate Construction	-	-	231,602	9,264
Real Estate Mortgage	203,540	-	1,112,814	51,829
Other	-	-	-	-
Consumer:				
Real Estate 1-4 Family First Mortgage	184,097	5,862	-	-
Real Estate 1-4 Family Junior Mortgage	384,849	2,248	59,296	3,261
Other Revolving and Installment	26,493	-	69,064	3,843
Total Impaired Loans	$ 1,745,202	$ 34,848	$ 2,409,182	$ 124,780

NOTE 4 LOANS (CONTINUED)

The Company does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are on nonaccrual.

Purchased Loans

The Company evaluated purchased loans for impairment in accordance with the provisions of ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. Purchased loans with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered impaired. The Company has elected to account for purchase credit impaired loans under the cost recovery method. Under the cost recovery method, no yield is accreted into income until the Company's cost is recovered. Thus, no accretable yield is reported as of December 31, 2014 and 2013.

Changes in the carrying amount and accretable yield for purchased impaired were as follows for the years ended December 31, 2014 and 2013:

	Purchased Impaired	
	Accretable Yield	Carrying Amount of Loans
Balance - Beginning of Period	$ -	$ 248,232
Additions	-	927,235
Accretion	-	-
Payments Received, Net	-	(718,676)
Balance - December 31, 2014	$ -	$ 456,791

	Purchased Impaired	
	Accretable Yield	Carrying Amount of Loans
Balance - Beginning of Period	$ -	$ 726,703
Accretion	-	-
Payments Received, Net	-	(478,471)
Balance - December 31, 2013	$ -	$ 248,232

There was no allowance for loan losses related to the purchased impaired loans at December 31, 2014 and 2013.

NOTE 4 LOANS (CONTINUED)

Troubled Debt Restructurings

There were no loans modified as trouble debt restructurings for the 12 months ended December 31, 2014 and 2013.

NOTE 5 PREMISES AND EQUIPMENT

Components of premises and equipment as of December 31, 2014 and 2013 are as follows:

	2014	2013
Land	$ 4,822,864	$ 4,822,864
Buildings and Improvements	24,084,097	24,401,140
Assets Under Capital Lease	2,657,274	2,657,274
Furniture, Fixtures and Equipment	27,085,166	25,391,632
Total	58,649,401	57,272,910
Less: Accumulated Depreciation	(37,193,093)	(34,710,199)
Net	$ 21,456,308	$ 22,562,711

Depreciation expense for the years ended December 31, 2014, 2013, and 2012 amounted to $3,142,132, $3,106,887, and $3,094,394, respectively.

Pursuant to the terms of the noncancelable lease agreements in effect at December 31, 2014, pertaining to banking premises, future minimum rent commitments under various operating leases are as follows:

Year Ending December 31,	Amount
2015	$ 2,537,312
2016	2,477,139
2017	2,265,066
2018	2,152,705
Thereafter	6,778,021
Total	$ 16,210,243

Total rent expense for the years ended December 31, 2014, 2013, and 2012 amounted to $2,657,438, $1,916,433, and $2,117,153, respectively.

NOTE 5 PREMISES AND EQUIPMENT (CONTINUED)

The annual minimum future rents due to the Company on noncancelable operating leases as of December 31, 2014 are as follows:

Year Ending December 31,	Amount
2015	$ 331,149
2016	314,075
2017	301,843
2018	274,386
Thereafter	1,484,734
Total Future Minimum Rentals	$ 2,706,187

NOTE 6 INTANGIBLE ASSETS

On March 11, 2011, the Company acquired select assets and liabilities of BNC National Bank branches located in Scottsdale and Minneapolis. The Company acquired $67,068,000 in assets and assumed $76,696,000 in liabilities. As part of the transaction, the Company allocated $515,000 to a core deposit intangible.

On February 1, 2012, the Company acquired select assets and liabilities of PensionTrend, Inc. and Pension Trend Investment Advisors, LLC located in Okemos, Troy, and Marquette, Michigan. The Company acquired $7,517,722 in assets and assumed $964,524 in liabilities. As part of the transaction, the Company allocated $7,040,482 to an identified customer intangible.

On September 30, 2013, the Company acquired select assets and liabilities of Tegrit Administrators, LLC located in Spartanburg, Ohio. As part of the transaction, the Company allocated $1,882,052 to an identified customer intangible.

On June 25, 2014, the Company acquired Private Bancorporation, Inc. with one branch located in downtown Minneapolis. As part of the transaction, the Company allocated $1,200,000 to a core deposit intangible and $851,799 to goodwill.

On October 1, 2014, the Company acquired Retirement Alliance, Inc. and its affiliate Fiduciary Consulting Group, LLC located in Manchester, NH. As part of the transaction, the Company allocated $12,716,445 to an identified customer intangible.

The Company follows U.S. GAAP with regard to Goodwill and Other Intangible Assets. Among its provisions is a requirement that the Company classify its intangible assets between assets subject to amortization and assets not subject to amortization.

NOTE 6 INTANGIBLE ASSETS (CONTINUED)

The following is a summary of the Company's nonservicing intangible assets:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Subject to Amortization:			
Core Deposits	$ 3,422,325	$ (2,222,158)	$ 1,200,167
Identifiable Customer Intangibles	36,161,766	(16,597,403)	19,564,363
Total Intangibles Subject to Amortization	$ 39,584,091	$ (18,819,561)	$ 20,764,530

Aggregate amortization expense for the years ended December 31, 2014, 2013, and 2012 was $4,196,462, $3,320,838, and $3,323,437, respectively.

Estimated aggregate amortization expenses for each of the next five years and thereafter is as follows:

Year Ending December 31,	Amount
2015	$ 5,894,493
2016	5,768,815
2017	4,002,514
2018	3,071,241
2019	2,027,467
Total	$ 20,764,530

NOTE 7 LOAN SERVICING

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of loans serviced for others totaled $518,820,769 and $472,262,509 at December 31, 2014 and 2013, respectively.

The balance of servicing rights included in intangible assets at December 31, 2014 and 2013 is $4,254,062 and $4,005,394, respectively. Servicing rights of $1,155,313, $1,778,912, and $1,360,747 were capitalized in 2014, 2013, and 2012, respectively. Amortization of servicing rights was $795,861, $831,871, and $1,016,234 in 2014, 2013, and 2012, respectively. Changes in fair value of servicing rights are recognized in other operating expenses and were $(110,784), $(434,673), and $160,697 in 2014, 2013, and 2012, respectively.

The amount of loan servicing obligations included in other liabilities is $-0- as of December 31, 2014 and 2013. Amortization of loan servicing obligations was $-0-, $3,955, and $4,125 in 2014, 2013, and 2012, respectively.

NOTE 7 LOAN SERVICING (CONTINUED)

The fair value of loan servicing rights and obligations were determined using discount rates averaging 9.80% as of December 31, 2014 and 2013 and prepayment speeds averaging 9.82% and 7.98%, respectively.

NOTE 8 OTHER ASSETS

Other assets on the balance sheet consist of the following balances as of December 31, 2014 and 2013:

	2014	2013
Federal Reserve Board Stock	$ 1,541,500	$ 1,083,550
Foreclosed Assets - Noncovered	1,985,414	1,558,450
Foreclosed Assets - Covered	492,766	3,318,690
Investments in Partnerships	4,465,966	868,056
Trust Fees Receivable	6,737,500	6,400,000
Income Tax Refund Receivable	2,450,451	-
Federal Home Loan Bank Stock	3,679,500	3,130,900
Other Assets	7,718,768	5,471,379
Total	$ 29,071,865	$ 21,831,025

Restricted investments include stock in the Federal Home Loan Bank and the Federal Reserve Bank. These investments are carried at cost which is the expected recoverability of the par value. The investments are required to be maintained in order to be members of the Federal Reserve Bank and to obtain borrowings from the Federal Home Loan Bank.

NOTE 9 DEPOSITS

	2014	2013
Savings Deposits	$ 30,396,522	$ 24,749,696
Interest-Bearing Checking Accounts	243,333,635	186,916,215
Money Market	447,345,968	439,945,943
Time Deposits	210,873,421	225,949,151
Total Interest-Bearing Deposits	931,949,546	877,561,005
Non-Interest Bearing Deposits	330,218,494	305,042,279
Total	$ 1,262,168,040	$ 1,182,603,284

Certificates of deposit in excess of $250,000 totaled $28,773,830 and $35,182,147 at December 31, 2014 and 2013, respectively.

NOTE 9 DEPOSITS (CONTINUED)

At December 31, 2014, the scheduled maturities of certificates of deposit are as follows:

Year Ending December 31,	Amount
2015	$ 158,519,812
2016	17,050,123
2017	6,269,156
2018	6,837,850
2019	8,525,354
Thereafter	13,671,126
Total	$ 210,873,421

NOTE 10 FEDERAL FUNDS PURCHASED

Federal Funds purchased at December 31, 2014 and 2013 were $-0-. The average interest rate charged on Federal Funds purchased during 2014 and 2013 was 0.29% and 0.20%, respectively.

At December 31, 2014, the Company had available $87,000,000 of unsecured lines of credit and no secured lines of credit for Federal Funds outstanding.

NOTE 11 REPURCHASE AGREEMENTS

The Company enters into agreements to repurchase the same securities that it previously sold. These agreements may have a fixed maturity or be open ended, callable at any time. The aggregate amount of repurchase agreements was $10,531,931 and $7,874,545 as of December 31, 2014 and 2013, respectively. Weighted average interest rates were 0.23% and 0.25% as of December 31, 2014 and 2013, respectively.

The securities underlying the agreements as of December 31, 2014 and 2013 were under the Company's control in safekeeping at third-party financial institutions.

NOTE 12 OTHER BORROWED FUNDS

Other borrowed funds at December 31, 2014 and 2013 consisted of the following:

	Interest Rate	2014	2013
Note payable, FHLB, interest due monthly February 2008 through February 2018, callable quarterly after February 5, 2009	2.16%	$ 20,000,000	$ 20,000,000
Obligations Under Capital Lease		1,494,009	1,629,820
Total		$ 21,494,009	$ 21,629,820

At November 1, 1999, the Company entered into a capital lease for a portion of a commercial office building in downtown Grand Forks, North Dakota. The depreciable cost of the lease is $2,657,274. The building and the related liability of the capital lease were recorded at the present value of future payments due under the lease provisions and were determined using an 8% discount rate.

The related liability under the lease, with a December 31, 2014 balance of $1,494,009, net of prepaid interest of $489,012, is due in monthly installments of $20,860 including interest through October 31, 2012. The lease payments were subsequently modified to $21,451 through October 31, 2017 and then $20,895 through October 31, 2022.

The following schedule represents the future minimum lease payments under the capital lease together with the present value of the net minimum lease payments as of December 31, 2014:

Year Ending December 31,	Amount
2015	$ 257,415
2016	257,415
2017	256,302
2018	250,735
2019	250,735
Later Years	710,419
Total Minimum Lease Payments	1,983,021
Less: Amount Representing Interest	(489,012)
Present Value Net Minimum Lease Payments	$ 1,494,009

NOTE 12 OTHER BORROWED FUNDS (CONTINUED)

As of December 31, 2014, the Company had $33,000,000 standby letters of credit with the Bank of North Dakota. Letters of credit are collateralized by loans pledged to the Bank of North Dakota in the amount of $263,637,471 as of December 31, 2014.

FHLB notes payable are collateralized by specific loans and investment securities with a carrying amount of approximately $267,865,985 and $21,675,079, respectively, at December 31, 2014. At December 31, 2014, the Company had the ability to borrow an additional $120,349,049 from the FHLB based on the value of loans and investment securities pledged to FHLB.

The Company also has a $30,000,000 lending facility with the Bank of North Dakota. This credit commitment consists of a $27,000,000 unsecured subordinated note and a $3,000,000 loan secured by 100% of the Bank's stock. The Company has received Federal Reserve approval for Tier 2 Capital treatment for the subordinated note. As of December 31, 2014, the Company has not drawn on these lending facilities.

As December 31, 2014, the Company is in compliance with the various covenants and restrictions of the loan agreements on the above debt.

NOTE 13 TRUE-UP LIABILITY

In connection with the Prosperan Bank acquisition in 2009, the Bank has agreed to pay the FDIC, should the estimated losses on the acquired loan portfolios as well as servicing fees earned on the acquired loan portfolios not meet thresholds as stated in the loss sharing agreement (the true-up liability). This contingent consideration is classified as a liability within other liabilities on the Consolidated Balance Sheet and is remeasured at fair value each reporting date until the contingency is resolved. The changes in fair value are recognized in non-interest income or expense.

An expected value methodology is used as a starting point for determining the fair value of the true-up liability based on the contractual terms prescribed in the loss sharing agreements. The resulting values under both calculations are discounted over 10 years (the period defined in the loss sharing agreements) to reflect the uncertainty in the timing and payment of the true-up liability by the Bank to arrive at a net present value. The discount rate used to value the true-up liability was 5% as of December 31, 2014 and 2013, respectively.

In accordance with the loss sharing agreements governing the Prosperan Bank acquisition, on January 14, 2020 (the rosperan True-Up Measurement Date), the Bank has agreed to pay to the FDIC half of the amount, if positive, calculated as: (1) 20% of the intrinsic loss estimate of the FDIC (approximately $13.2 million); minus (2) the sum of (A) 25% of the asset discount paid in connection with the Prosperan Bank acquisition (approximately $4.8 million); plus (B) 25% of the cumulative shared-loss payments (as defined below) plus (C) the cumulative servicing amount (as defined below). The fair value of the true-up liability associated with the Prosperan acquisition was $2.6 million as of December 31, 2014 and 2013.

NOTE 13 TRUE-UP LIABILITY (CONTINUED)

For the purposes of the above calculations, cumulative shared-loss payments means: (i) the aggregate of all of the payments made or payable to the Bank under the loss sharing agreements minus (ii) the aggregate of all of the payments made or payable to the FDIC. The cumulative servicing amount means the period servicing amounts (as defined in the loss sharing agreements) for every consecutive 12-month period prior to and ending on the Prosperan Bank True-Up Measurement Dates. The cumulative loss share payments and cumulative service amounts components of the true-up calculations are estimated each period end based on the expected amount and timing of cash flows of the acquired loan portfolios.

NOTE 14 FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

In the normal course of business, the Bank has outstanding commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying consolidated financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the statements of financial condition.

At December 31, 2014 and 2013, the following financial instruments whose contract amount represents credit risk were approximately as follows:

	2014	2013
Commitments to Extend Credit	$ 407,356,122	$ 309,088,000
Standby Letters of Credit	6,050,533	7,115,000
Total	$ 413,406,655	$ 316,203,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income producing commercial properties.

NOTE 14 FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK (CONTINUED)

Standby letters-of-credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Standby letters-of-credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

The Bank was not required to perform on any financial guarantees and did not incur any losses on its commitments during the past two years.

The Mortgage Partnership Finance (MPF) Program, which is available through most Federal Home Loan Banks (FHLBs), provides member financial institutions an alternative method for funding home mortgages for their customers. Under the MPF Program, the lender effectively originates loans for, or sells loans to, the respective FHLB. The lender retains some or all of the credit risk and customer relationship (through servicing) inherent in the loan, and shifts the interest rate risk and prepayment risk to the FHLB. The lender receives a credit enhancement fee from the FHLB in exchange for managing the credit risk of the loan. Total commitments under the program amounted to $4,062,294 and $2,812,742 at December 31, 2014 and 2013, respectively.

NOTE 15 LEGAL CONTINGENCIES

The Company may be subject to claims and lawsuits which may arise primarily in the ordinary course of business. It is the opinion of management, if such claims are made, that the disposition or ultimate resolution of the claims and lawsuits will not have a material adverse effect on the financial position of the Company.

NOTE 16 STOCK BASED COMPENSATION PLANS

In April 1991, the stockholders approved the adoption of the Alerus Financial Corporation 1991 Stock Award Plan (the 1991 Plan) providing for the grant of up to 1,800,000 shares of its common stock to certain key employees in the form of restricted stock awards, and incentive and nonqualified stock options. The 1991 Plan is administered by a committee elected by the Board and consists of three or more directors, none of whom may be a participant in the 1991 Plan. The Committee has sole discretion, subject to the terms of the Plan, to adopt and revise rules of the 1991 Plan and to determine those key employees who may participate along with the timing, amounts and other terms and conditions of awards.

NOTE 16 STOCK BASED COMPENSATION PLANS (CONTINUED)

The 1991 Plan provides for the granting of restricted stock at no cost to certain key employees. Shares of stock are issued to each employee immediately upon the grant of the award and the employee becomes entitled to all rights of a shareholder, unless such shares are forfeited under the plan. The restricted stock is subject to full or partial forfeiture, as defined, if the employee terminates employment with the Company within prescribed time periods or violates any restrictions under their agreement. Restricted stock awards generally vest over a 5- to 10-year period, but vesting may be accelerated or immediate due to death or disability of the employee or the occurrence of certain events relating primarily to significant changes in directors or ownership of the Company. Restricted stock awards are considered to represent an element of employee compensation and is charged to expense over the period earned. Compensation expense relating to stock awards under this plan was $39,094 in 2014, $147,524 in 2013, and $291,938 in 2012.

In addition, the 1991 Plan provides the ability to grant incentive and nonqualified stock options with terms fixed by the Committee at the time of grant. There were no options outstanding as December 31, 2014, 2013, and 2012.

The Company also adopted a retainer stock plan for its Board of Directors (the Retainer Plan) in 1991. The purpose of the Retainer Plan is to provide for payment of the annual retainer to directors in shares of Company common stock. The number of shares to be issued is based on the retainer divided by the fair market value per share as of the applicable date, as defined. The Company issued 5,877, 8,279, and 6,216 shares in connection with the Retainer Plan for the years ended December 31, 2014, 2013, and 2012, respectively. Upon the issuance of shares under this plan, the then current value of the shares is charged to expense.

Effective May 2009, the Company adopted the Alerus Financial Corporation 2009 Stock Award Plan (the 2009 Plan) providing for the grant of up to 1,350,000 shares of its common stock to employees, officers, and directors pursuant to awards of non-qualified options, restricted stock, or other stock-based employee benefits.

The 2009 Plan provides for the granting of restricted stock at no cost to certain key employees. Shares of stock are issued to each employee immediately upon the grant of the award and the employee becomes entitled to all rights of a shareholder, unless such shares are forfeited under the plan. The restricted stock is subject to full or partial forfeiture, as defined, if the employee terminates employment with the Company within prescribed time periods (generally 5 to 10 years) or violates any restrictions under their agreement. Restricted stock awards generally vest over a 5- to 10-year period, but vesting may be accelerated or immediate due to death or disability of the employee or the occurrence of certain events relating primarily to significant changes in directors or ownership of the Company. Restricted stock awards are considered to represent an element of employee compensation and is charged to expense over the period earned. Compensation expense relating to stock awards under this plan was $1,022,181 in 2014, $795,238 in 2013, and $507,186 in 2012.

NOTE 16 STOCK BASED COMPENSATION PLANS (CONTINUED)

In addition, the 2009 Plan provides the ability to grant nonqualified stock options with terms fixed by the Committee at the time of grant. There were no options outstanding as December 31, 2014, 2013, or 2012.

Amounts granted under the 1991 and 2009 plan have been retroactively adjusted for all stock splits effected in the form of dividends.

Activity in the stock plans for the years ended December 31, 2014, 2013, and 2012 is as follows:

	Number of Shares	
	Available for Future Grant	Restricted Stock Award
Balance - December 31, 2011	1,147,809	1,666,671
Restricted Units Awarded	(6,897)	6,897
Restricted Stock Awarded	(158,505)	158,505
Balance - December 31, 2012	982,407	1,832,073
Restricted Units Awarded	(4,392)	4,392
Restricted Stock Awarded	(185,835)	185,835
Awards Forfeited	9,357	(9,357)
Balance - December 31, 2013	801,537	2,012,943
Restricted Units Awarded	(2,682)	2,682
Restricted Stock Awarded	(89,346)	89,346
Balance - December 31, 2014	709,509	2,104,971

The number of unvested shares outstanding was 606,144, 684,360, and 777,260 respectively, as of years ended December 31, 2014, 2013, and 2012.

NOTE 17 EMPLOYEE BENEFITS

Retirement Plans

The Company maintains two employee retirement plans including a defined benefit employee stock ownership plan (ESOP) and a defined contribution salary reduction profit sharing plan. The plans cover substantially all full-time employees upon satisfying prescribed eligibility requirements for age and length of service. Contributions to the non-contributory profit sharing plan and the ESOP are determined annually by the Board of Directors at their discretion and allocated to participants based on a percentage of annual compensation. Under the salary reduction profit sharing plan, the Company contributes 100% of amounts deferred by employees up to 3% of eligible compensation and 50% of amounts deferred by employees between 3% and 6% of eligible compensation. Under the ESOP, corporate stock is transferred to the plan at market value on date of transfer. The Company treats these as outstanding shares, accordingly, dividends on these shares are charged to retained earnings.

NOTE 17 EMPLOYEE BENEFITS (CONTINUED)

Retirement plan contributions are reflected under employee benefits in the income statement as follows:

	2014	2013	2012
Salary Reduction Plan	$ 1,603,645	$ 1,550,472	$ 1,454,096
ESOP	1,148,502	1,106,098	1,018,323
Total	$ 2,752,147	$ 2,656,570	$ 2,472,419
Total ESOP Shares Outstanding	1,312,827	1,338,018	1,318,152

Under Federal income tax regulations, the employer stock that is held by the plan and its participants is not readily tradable on an established market, or is subject to trading limitations and includes a put option. The put option is a right to demand that the Company buy any shares of its stock distributed to participants for which there is no market. The put price is representative of the fair market value of the stock. The Company's ESOP repurchase obligation was $25,928,333, $25,734,546, and $18,585,943 respectively, for years ended December 31, 2014, 2013, and 2012.

NOTE 18 OTHER OPERATING INCOME AND EXPENSES

The components of other operating income and other operating expenses including those which exceed 1% of the aggregate of total interest income and other income for the years ended December 31, 2014, 2013, and 2012 are as follows:

	2014	2013	2012
Other Operating Income:			
Security Brokerage Commissions	$ 2,041,508	$ 2,039,022	$ 1,977,953
Investment Advisory Fees	994,508	1,321,142	1,251,309
Interchange Fees	1,704,396	1,529,324	1,449,012
Bank Owned Life Insurance Income	821,088	832,411	850,661
Other Operating Income	1,297,378	1,446,304	1,289,719
Total Other Operating Income	$ 6,858,878	$ 7,168,203	$ 6,818,654
Other Operating Expenses:			
Marketing, Business Development and Public Relations	$ 2,745,276	$ 2,613,161	$ 3,051,600
Supplies, Telephone and Postage	3,838,311	3,032,689	3,148,351
FDIC Insurance	1,039,911	960,233	893,177
Professional Fees - Legal, Audit and Consulting	2,667,373	2,041,754	1,894,369
Correspondent and Other Outside Service Fees	6,981,431	5,547,163	5,668,011
Net Expenses of OREO and Other Property Including Gain or Loss on Disposal	678,118	668,477	108,296
True-Up Liability Expense	-	-	2,605,000
Indemnification Asset Write-Off	-	-	5,121,173
Other Expenses	12,663,263	9,747,337	10,633,692
Total Other Operating Expenses	$ 30,613,683	$ 24,610,814	$ 33,123,669

NOTE 19 PRIOR PERIOD ADJUSTMENT

During the 1st quarter of 2015, an accounting error was identified that relates to the year ended December 31, 2012; therefore the financial statements as of and for the years ended December 31, 2013 and 2012 have been restated. The Company identified an error related to the FDIC true-up liability as a part of the acquisition of Prosperan Bank in 2009. The Company determined a liability should have been recorded as of December 31, 2012. The net effect of this error on the Company's financial statements for the year ended December 31, 2012 was that net income was overstated by $1,613,016. The impact of the correction of the error noted above to the Company's previously reported consolidated financial statements as of and for the years ended December 31, 2013 and 2012 are summarized below:

	As Previously Reported	Impact of the Restatement	As Restated
December 31, 2013:			
Deferred Tax Assets, Net	$ 8,644,783	$ 991,984	$ 9,636,767
Other Liabilities	7,184,361	2,605,000	9,789,361
Retained Earnings	111,452,931	(1,613,016)	109,839,915
December 31, 2012:			
Deferred Tax Assets, Net	$ 5,000,975	$ 991,984	$ 5,992,959
Other Liabilities	19,461,609	2,605,000	22,066,609
Retained Earnings	96,235,538	(1,613,016)	94,622,522
Other Non-Interest Expense	30,518,669	2,605,000	33,123,669
Income Tax Expense	10,450,064	(991,984)	9,458,080
Net Income	17,869,225	(1,613,016)	16,256,209
Net Income Applicable to Common Stock	17,529,780	(1,613,016)	15,916,764
Earnings Per Share	1.29	(0.12)	1.17

NOTE 20 INCOME TAXES

The components of income tax expense (benefit) for the years ended December 31, 2014, 2013, and 2012 are as follows:

	2014	2013	2012
Current:			
Federal	$ 10,521,053	$ 10,724,658	$ 10,465,907
State	75,706	1,932,765	2,065,578
Total	10,596,759	12,657,423	12,531,485
Deferred:			
Federal	(917,991)	(829,395)	(2,674,799)
State	(140,967)	(144,531)	(398,606)
Total	(1,058,958)	(973,926)	(3,073,405)
Total Current and Deferred:			
Federal	9,603,062	9,895,263	7,791,108
State	(65,261)	1,788,234	1,666,972
Total Current and Deferred:	$ 9,537,801	$ 11,683,497	$ 9,458,080

NOTE 20 INCOME TAXES (CONTINUED)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2014 and 2013 are as follows:

	2014	2013
Deferred Tax Assets		
Allowance for Loan Losses	$ 6,497,780	$ 6,584,906
Employee Compensation and Benefit Accruals	2,455,798	2,391,331
Identifiable Intangible Amortization	3,035,841	2,238,214
Acquired Loans	2,849,839	-
Net Operating Loss Carryforwards	1,092,694	-
Nonaccrual Loan Interest	262,790	202,586
Other	2,180,506	1,637,980
	18,375,248	13,055,017
Valuation Allowance	(167,138)	-
Total Deferred Tax Assets from Temporary Differences	18,208,110	13,055,017
Deferred Tax Liabilities		
Accumulated Depreciation	475,793	771,327
Goodwill Amortization	538,458	217,865
Servicing Assets	1,658,273	1,566,109
Acquired Loans	170,652	226,110
Acquisition Gain	-	87,157
Prepaid Expenses	366,995	378,019
Other	33,910	51,760
Total Deferred Tax Liabilities from Temporary Differences	3,244,081	3,298,347
Deferred Tax Liability from Unrealized Gain on Available-for-Sale Investment Securities	787,285	119,903
Total Deferred Liabilities	4,031,366	3,418,250
Net Deferred Tax Assets	$ 14,176,744	$ 9,636,767

The reconciliation between applicable income taxes and the amount computed at the applicable statutory Federal tax rate is as follows:

	2014		2013		2012	
	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Taxes at Statutory Federal Income Tax Rate	$ 10,419,167	35.0 %	$ 11,183,738	35.0 %	$ 9,000,001	35.0 %
Increase (Decrease) in Taxes (Benefit) Resulting from:						
Tax Exempt Income, Net of Disallowed Interest Expense	(589,191)	(1.9)	(557,177)	(1.7)	(584,469)	(2.3)
State Income Taxes, Net of Federal Benefits	153,468	0.5	1,162,352	3.6	1,055,451	4.1
Nondeductible Items and Other	(445,643)	(1.5)	(105,416)	(0.3)	(12,903)	-
Applicable Income Taxes	$ 9,537,801	32.1 %	$ 11,683,497	36.6 %	$ 9,458,080	36.8 %

NOTE 20 INCOME TAXES (CONTINUED)

During the fourth quarter of 2014, the Company completed an analysis of revenue apportionment for state income tax purposes. As a result of that analysis, the Company determined the use of an alternative method of allocating revenue was permitted. During 2014, the Company filed amended state tax returns for 2011 through 2013 to claim appropriate refunds. As a result, the Company increased its current income taxes receivable and recognized a current tax benefit of $1,124,465. These state amended tax returns are subject to review by the various jurisdictions. The statute of limitations has been extended to December 31, 2014 for tax periods ended December 31, 2011 to 2013.

The federal income tax returns of the Company are subject to examination by the IRS, generally three years after they were filed. All of the tax filings of the Company are current.

It is the opinion of management that the Company has no significant uncertain tax positions that would be subject to change upon examination.

NOTE 21 RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank has granted loans to executive officers, directors, and their affiliates (related parties). These loans are made on substantially the same terms and conditions as those prevailing at the time for comparable transactions with outsiders and are not considered to involve more than the normal risk of collectability. Loans outstanding both direct and indirect to directors and executive officers totaled $5,956,542 at December 31, 2014 and $3,646,256 at December 31, 2013. During 2014, new loans totaling $11,781,565 were made and $9,471,279 were repaid.

Deposits from related parties held by the Bank at December 31, 2014 and 2013 amounted to $7,976,781 and $8,423,041, respectively.

NOTE 22 PREFERRED STOCK

On August 18, 2011, the Company completed the sale of $20,000,000 of Series A preferred stock to the Secretary of the Treasury under the Small Business Lending Fund (SBLF). The fund was established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets less than $10 billion. Under the terms of the stock purchase agreement, the Treasury received 20,000 shares of noncumulative perpetual preferred stock with a liquidation value of $1,000 per share, in exchange for $20,000,000.

NOTE 22 PREFERRED STOCK (CONTINUED)

The Series A preferred stock qualifies as Tier 1 capital. The dividend rate, as a percentage of the liquidation amount, can fluctuate on a quarterly basis during the first 10 quarters during which the Series A preferred stock is outstanding, based upon changes in the level of “Qualified Small Business Lending” or “QSBL”. The dividend rate for the initial dividend period (which ended September 30, 2011) was 1.0%. Based upon the increase in level of QSBL over the baseline level calculated under the terms of the related purchase agreement, the dividend rate for the second dividend period ending on December 31, 2011, was 1.0%. For the third through tenth calendar quarters, the dividend rate may be adjusted to between 1.0% and 5.0% per annum based upon the increase in QSBL as compared to the baseline. For the eleventh calendar quarter through four and one-half years after issuance, the dividend rate will be fixed at between 1.0% and 7.0% based upon the level of QSBL compared to the baseline. After four and one-half years from the issuance, the dividend rate will increase to 9.0% (including a quarterly lending incentive fee of 0.5%). Subject to regulatory approval, the Company is generally permitted to redeem the Series A preferred shares at par plus unpaid dividends.

There was no discount recorded related to the SBLF preferred stock (because no warrants were issued in connection with this preferred stock issuance) and, therefore, there will be no future amounts recorded for preferred stock discount accretion.

Preferred shares outstanding rank senior to common shares both as to dividends and liquidation preference but have no voting rights.

NOTE 23 DERIVATIVES

The Company maintains an overall interest-rate risk-management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest-rate volatility. The Company's goal is to manage interest-rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net-interest margin is not, on a material basis, adversely affected by movements in interest rates. As a result of interest-rate fluctuations, hedged assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation will generally be offset by income or loss on the derivative instruments that are linked to the hedged assets and liabilities. The Company views this strategy as a prudent management of interest-rate sensitivity, such that earnings are not exposed to undue risk presented by changes in interest rates.

NOTE 23 DERIVATIVES (CONTINUED)

Derivative instruments that are used as part of the Company's interest-rate risk-management strategy include interest-rate swaps, futures contracts, and options contracts with indices that relate to the pricing of specific balance-sheet assets and liabilities. Interest-rate swaps generally involve the exchange of fixed- and variable-rate interest payments between two parties, based on a common notional principal amount and maturity date. Interest-rate options represent contracts that allow the holder of the option to (1) receive cash or (2) purchase, sell or enter into a financial instrument at a specified price within a specified period of time. Certain of these contracts also provide the Company with the right to enter into interest-rate swaps and cap and floor agreements with the writer of the option.

By using derivative instruments, the Company is exposed to credit and market risk. If the counterparty fails to perform, credit risk is equal to the extent of the fair-value gain in a derivative. When the fair value of a derivative contract is positive, this generally indicates that the counterparty owes the Company and, therefore, creates a repayment risk for the Company. When the fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, it has no repayment risk. The Company minimizes the credit (or repayment) risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically by the Company's credit committee. The Company also maintains a policy of requiring that all derivative contracts be governed by an International Swaps and Derivatives Association Master Agreement.

Various derivatives, including interest rate, commodity, equity, credit and foreign exchange contracts, are offered to customers but usually offset the exposure from such contracts by purchasing other financial contracts. The customer accommodations and any offsetting financial contracts are treated as freestanding derivatives. Free-standing derivatives also include derivatives entered into for risk management that do not otherwise qualify for hedge accounting, including economic hedge derivatives.

During 2010, the Company entered into a three year interest rate corridor transaction agreement with notional principal of $200 million. The corridor agreement is effective May 18, 2010 and expires May 18, 2013. The Company did not designate this transaction as a hedging instrument.

NOTE 23 DERIVATIVES (CONTINUED)

The following tables present the total notional or contractual amounts and fair values for derivatives not designated as hedging instruments that are recorded on the balance sheet in other assets or other liabilities. Customer accommodation, trading and other free-standing derivatives are recorded on the balance sheet at fair value in trading assets or other liabilities as of December 31, 2014 and 2013:

	Balance at December 31, 2014		
		Fair Value	
December 31, 2014	Notional Amount	Derivative Assets	Derivative Liabilities
Derivatives Not Designed as Qualifying Hedging Instruments:			
Free Standing Derivatives (Economic Hedges)			
Interest Rate Contracts	$ 632,148	$ 39,025	$ 39,025
Customer Accommodation, Trading, and Other Contracts:			
Interest Rate Contracts	12,451,306	82,177	42,255
Total Derivatives Not Designated as Qualifying Hedging Instruments		$ 121,202	$ 81,280

	Balance at December 31, 2013		
		Fair Value	
December 31, 2013	Notional Amount	Derivative Assets	Derivative Liabilities
Derivatives Not Designed as Qualifying Hedging Instruments:			
Free Standing Derivatives (Economic Hedges)			
Interest Rate Contracts	$ 658,901	$ 40,473	$ 40,473
Customer Accommodation, Trading, and Other Contracts:			
Interest Rate Contracts	11,047,649	48,949	21,809
Total Derivatives Not Designated as Qualifying Hedging Instruments		$ 89,422	$ 62,282

The gain (loss) recognized on derivative instruments at December 31, 2014 and 2013 was as follows:

Derivatives Not Designated as Hedging Instruments	Location of Gain or Loss Recognized in Income Derivative	Amount of Gain or (Loss) Recognized in Income on Derivative	
		2014	2013
Interest Rate Contracts	Other Income (Expenses)	$ 12,782	$ 39,792

NOTE 24 REGULATORY MATTERS

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following tables) of total and Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2014 and 2013, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2014, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as Well Capitalized under the regulatory framework for prompt corrective action. To be categorized as Well Capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Company's and the Bank's actual capital amounts and ratios as of December 31, 2014 and 2013 are presented in the following tables.

	Actual		*Minimum Capital*		*Minimum to be Well*	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2014						
Total Capital						
(to Risk Weighted Assets)						
Consolidated	$ 162,778,000	13.1%	$ 99,406,000	≥ 8.0%	N/A	N/A
Alerus Financial	155,810,000	12.6%	98,927,000	≥ 8.0%	$ 123,659,000	≥ 10.0%
Tier 1 Capital						
(to Risk Weighted Assets)						
Consolidated	147,192,000	11.8%	49,896,000	≥ 4.0%	N/A	N/A
Alerus Financial	140,320,000	11.3%	49,671,000	≥ 4.0%	74,506,000	≥ 6.0%
Tier 1 Capital						
(to Average Assets)						
Consolidated	147,192,000	10.1%	58,294,000	≥ 4.0%	N/A	N/A
Alerus Financial	140,320,000	9.7%	57,864,000	≥ 4.0%	72,330,000	≥ 5.0%

NOTE 24 REGULATORY MATTERS (CONTINUED)

	Actual		*Minimum Capital*		*Minimum to be Well*	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2013						
Total Capital						
(to Risk Weighted Assets)						
Consolidated	$ 154,756,000	14.1%	$ 87,805,000	≥ 8.0%	N/A	N/A
Alerus Financial	147,972,000	13.5%	87,687,000	≥ 8.0%	$ 109,609,000	≥ 10.0%
Tier 1 Capital						
(to Risk Weighted Assets)						
Consolidated	141,011,000	12.8%	44,066,000	≥ 4.0%	N/A	N/A
Alerus Financial	134,283,000	12.3%	43,669,000	≥ 4.0%	65,504,000	≥ 6.0%
Tier 1 Capital						
(to Average Assets)						
Consolidated	141,011,000	10.6%	53,212,000	≥ 4.0%	N/A	N/A
Alerus Financial	134,283,000	10.1%	53,181,000	≥ 4.0%	66,477,000	≥ 5.0%

The Bank is subject to certain restrictions on the amount of dividends that it may pay without prior regulatory approval. The Bank normally restricts dividends to a lesser amount.

In July 2013 the U.S. federal banking authorities approved the final rules (the Basel III Capital Rules) which established a new comprehensive capital framework for U.S. banking organizations. The Basel III Capital Rules have maintained the general structure of the current prompt corrective action framework, while incorporating provisions which will increase both the quality and quantity of the Bank's capital. Generally, the Bank becomes subject to the new rules on January 1, 2015 with phase-in periods for many of the new provisions. Management believes the Bank will comply with the new capital requirements as they are phased-in.

In addition, the Company must adhere to various U.S. Department of Housing and Urban Development (HUD) regulatory guidelines including required minimum capital and liquidity to maintain their Federal Housing Administration approved status. Failure to comply with the HUD guidelines could result in withdrawal of this certification. As of December 31, 2014, the Company was in compliance with HUD guidelines.

NOTE 25 FAIR VALUE MEASUREMENTS

The Company categorizes its assets and liabilities measured at fair value into a three-level hierarchy based on the priority of the inputs to the valuation technique used to determine fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used in the determination of the fair value measurement fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement. Assets and liabilities valued at fair value are categorized based on the inputs to the valuation techniques as follows:

Level 1 – Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that an entity has the ability to access.

Level 2 – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

Subsequent to initial recognition, the Company may remeasure the carrying value of assets and liabilities measured on a nonrecurring basis to fair value. Adjustments to fair value usually result when certain assets are impaired. Such assets are written down from their carrying amounts to their fair value.

Professional standards allow entities the irrevocable option to elect to measure certain financial instruments and other items at fair value for the initial and subsequent measurement on an instrument-by-instrument basis. The Company adopted the policy to value certain financial instruments at fair value. The Company has not elected to measure any existing financial instruments at fair value; however, it may elect to measure newly acquired financial instruments at fair value in the future.

NOTE 25 FAIR VALUE MEASUREMENTS (CONTINUED)

Recurring Basis

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. For additional information on how the Company measures fair value refer to Note 1 – Summary of Significant Accounting Principles to the Consolidated Financial Statements. The following tables present the balances of the assets and liabilities measured at fair value on a recurring basis as of December 31, 2014 and 2013:

December 31, 2014	Level 1	Level 2	Level 3	Total
Trading Securities:				
U.S. Treasury and Government Agency Securities	$ -	$ 1,960,062	$ -	$ 1,960,062
Available-for-Sale Securities:				
U.S. Treasury and Government Agency Securities	$ -	$ 88,497,805	$ -	$ 88,497,805
Obligations of State and Political Agencies	-	27,970,445	-	27,970,445
Mortgage Backed Securities:				
Residential Agency	-	81,407,104	-	81,407,104
Commercial	-	1,044,808	264,285	1,309,093
Equity Securities	4,956,816	-	-	4,956,816
Total Investment Securities	$ 4,956,816	$ 198,920,162	$ 264,285	$ 204,141,263
Other Assets:				
Derivatives	$ -	$ -	$ 82,177	$ 82,177
Total Other Assets	$ -	$ -	$ 82,177	$ 82,177
Other Liabilities	$ -	$ -	$ 42,255	$ 42,255

December 31, 2013	Level 1	Level 2	Level 3	Total
Trading Securities:				
U.S. Treasury and Government Agency Securities	$ 26,300	$ 1,874,528	$ -	$ 1,900,828
Available-for-Sale Securities:				
U.S. Treasury and Government Agency Securities	$ -	$ 85,228,460	$ -	$ 85,228,460
Corporate Debt Securities	-	38,940,279	-	38,940,279
Mortgage Backed Securities:				
Residential Agency	-	91,856,127	-	91,856,127
Commercial	-	1,748,312	281,033	2,029,345
Other Debt Securities	-	83,776	-	83,776
Equity Securities	4,741,494	-	-	4,741,494
Total Investment Securities	$ 4,741,494	$ 217,856,954	$ 281,033	$ 222,879,481
Other Assets				
Derivatives	$ -	$ -	$ 48,949	$ 48,949
Total Other Assets	$ -	$ -	$ 48,949	$ 48,949
Other Liabilities			$ 21,089	$ 21,089

NOTE 25 FAIR VALUE MEASUREMENTS (CONTINUED)

Recurring Basis (Continued)

Balance at December 31, 2014	Commercial Mortgage-Backed Securities	Derivatives Interest Rate Contracts	Total
Beginning Balance	$ 281,033	$ 48,949	$ 329,982
Total Gains (Losses) (Realized/Unrealized):			
Included in Earnings (or Changes in Net Assets)	-	(6,694)	(6,694)
Included in Other Comprehensive Income	(16,748)	-	(16,748)
Purchases, Issuances and Settlements	-	-	-
Transfers In and/or Out of Level 3	-	-	-
Ending Balance	$ 264,285	$ 42,255	$ 306,540
The Amount of Total (Gains) Losses for the Period Included in Earnings (or Changes in Net Assets) attributable to the Change in Unrealized Gains or Losses Relating to Assets Still Held at the Reporting Date	$ -	$ -	$ -

Balance at December 31, 2013	Commercial Mortgage-Backed Securities	Derivatives Interest Rate Contracts	Total
Beginning Balance	$ 300,195	$ 111,386	$ 411,581
Total Gains (Losses) (Realized/Unrealized):			
Included in Earnings (or Changes in Net Assets)	-	(62,437)	(62,437)
Included in Other Comprehensive Income	(19,162)	-	(19,162)
Purchases, Issuances and Settlements	-	-	-
Transfers In and/or Out of Level 3	-	-	-
Ending Balance	$ 281,033	$ 48,949	$ 329,982
The Amount of Total (Gains) Losses for the Period Included in Earnings (or Changes in Net Assets) attributable to the Change in Unrealized Gains or Losses Relating to Assets Still Held at the Reporting Date	$ -	$ (62,437)	$ (62,437)

NOTE 25 FAIR VALUE MEASUREMENTS (CONTINUED)

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Investment Securities

When available, the Company uses quoted market prices to determine the fair value of securities; such items are classified in Level 1 of the fair value hierarchy. For the Company's securities for which quoted prices are not available for identical securities in an active market, the Company determines fair value utilizing vendors who apply matrix pricing for similar bonds for which no price is observable or may compile prices from various sources. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, volatility factors, prepayment speeds, default rates, loss severity, current market, and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace. Fair values from these models are verified, where possible, against quoted market prices for recent trading activity of assets with similar characteristics to the security being valued. Such methods are generally classified as Level 2. However, when prices from independent sources vary, cannot be obtained, or cannot be corroborated, a security is generally classified as Level 3.

Derivatives

All of the Companies derivatives are traded in over-the-counter markets where quoted market prices are not readily available. For these derivatives, fair value is measured using internally developed models that use primarily market observable inputs, such as yield curves and option volatilities, and, accordingly, classify as Level 2. Examples of Level 2 derivatives are basic interest rate swaps and forward contracts. Any remaining derivative fair value measurements using significant assumptions that are unobservable are classified as Level 3. Level 3 derivatives include interest rate lock commitments written for residential mortgage loans that are held for sale.

Cash Surrender Value of Life Insurance

The cash surrender value of life insurance is carried at fair value which was determined based on the amount due upon surrender of the policy. This amount was provided by the insurance Company based on the terms of the underlying insurance contract.

Nonrecurring Basis

Certain assets are measured at fair value on a nonrecurring basis. These assets are not measured at fair value on an ongoing basis; however, they are subject to fair value adjustments in certain circumstances, such as when there is evidence of impairment or a change in the amount of previously recognized impairment.

NOTE 25 FAIR VALUE MEASUREMENTS (CONTINUED)

Nonrecurring Basis (Continued)

Net impairment losses related to nonrecurring fair value measurements of certain assets for the years ended December 31, 2014 and 2013 consisted of the following:

2014	Level 2	Level 3	Total	Total Losses
Loans Held for Sale	$ 35,041,951	$ -	$ 35,041,951	$ -
Impaired Loans	1,811,329	-	1,811,329	-
Other Real Estate	1,450,880	-	1,450,880	77,460
Servicing Rights	-	4,254,063	4,254,063	(110,784)

2013	Level 2	Level 3	Total	Total Losses
Loans Held for Sale	$ 30,253,556	$ -	$ 30,253,556	$ -
Impaired Loans	1,089,778	-	1,089,778	-
Other Real Estate - Noncovered	1,558,450	-	1,558,450	(74,581)
Other Real Estate - Covered	3,318,690	-	3,318,690	(22,181)
Servicing Rights	-	3,138,537	3,138,537	(221,751)

Loans Held for Sale

Mortgage loans originated and held for sale are carried at the lower of cost or estimated fair value. The Company obtains quotes or bids on these loans directly from purchasing financial institutions. Typically these quotes include a premium on the sale and thus these quotes indicate fair value of the held for sale loans is greater than cost.

Impairment losses for loans held for sale that are carried at the lower of cost or fair value represent additional net write-downs during the period to record these loans at the lower of cost or estimated fair value subsequent to their initial classification as loans held for sale.

Impaired Loans

In accordance with the provisions of the loan impairment guidance, impairment was measured for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceeds the recorded investments in such loans. Impaired loans for which an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. Collateral values are estimated using Level 2 inputs based on customized discounting criteria.

Impairment amounts on impaired loans represent specific valuation allowance and write-downs during the period presented on impaired loans that were individually evaluated for impairment based on the estimated fair value of the collateral less estimated selling costs, excluding impaired loans fully charged-off.

NOTE 25 FAIR VALUE MEASUREMENTS (CONTINUED)

Foreclosed Assets

Foreclosed assets are recorded at fair value based on property appraisals, less estimated selling costs, at the date of the transfer with any impairment amount charged to the allowance for loan losses. Subsequent to the transfer, foreclosed assets are carried at the lower of cost or fair value, less estimated selling costs with changes in fair value or any impairment amount recorded in other non-interest expense. Values are estimated using Level 2 inputs based on customized discounting criteria. The carrying value of foreclosed assets is not re-measured to fair value on a recurring basis but is subject to fair value adjustments when the carrying value exceeds the fair value, less estimated selling costs.

Servicing Rights

Servicing rights do not trade in an active market with readily observable prices. Accordingly, the fair value of servicing rights is determined using a valuation model that calculates the present value of estimated future net servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, the cost to service, escrow account earnings, contractual servicing fee income, ancillary income and late fees. Servicing rights are carried at lower of cost or market value, and therefore can be subject to fair value measurements on a nonrecurring basis. Fair value measurements of servicing rights use significant unobservable inputs and, accordingly, are classified as Level 3. The Company obtains the fair value of servicing rights from an independent third party pricing service and records the unadjusted fair values in the financial statements.

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. In cases in which quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimate of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases could not be realized in immediate settlement of the instruments. Certain financial instruments with a fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Company.

The following disclosures represent financial instruments in which the ending balances at December 31, 2014 and 2013 are not carried at fair value in their entirety on the consolidated balance sheets.

NOTE 25 FAIR VALUE MEASUREMENTS (CONTINUED)

Cash and Cash Equivalents and Accrued Interest

The carrying amounts reported in the consolidated balance sheets approximate those assets' and liabilities' fair values.

Securities Held to Maturity

Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. If quoted market prices of comparable instruments are not available, fair values are derived from other valuation methodologies, including option pricing models, discounted cash flow models, or similar techniques.

Loans

For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values of other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Deposits

The fair values of demand deposits are, by definition, equal to the amount payable on demand at the consolidated balance sheet date. The fair values of fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies current incremental interest rates being offered on certificates of deposit to a schedule of aggregated expected monthly maturities of the outstanding certificates of deposit.

Borrowed Funds

For variable-rate borrowings that reprice frequently, fair values are based on carrying values. The fair value of fixed-rate borrowings are estimated using discounted cash flow analysis, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Off-Balance-Sheet Credit-Related Instruments

Off-Balance-Sheet Credit Related Instrument commitments are generally of a short-term nature. The contract amount of such commitments approximates their fair value since the commitments are comprised primarily of unfunded loan commitments which are generally priced at market at the time of funding.

NOTE 25 FAIR VALUE MEASUREMENTS (CONTINUED)

Off-Balance-Sheet Credit-Related Instruments (Continued)

The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments are as follows:

	December 31, 2014					December 31, 2013	
	Carrying	Estimated Fair Value				Carrying	Fair
Financial Assets	Amount	Level 1	Level 2	Level 3	Total	Amount	Value
Cash and Cash Equivalents	$ 45,526,087	$ 45,526,087	$ -	$ -	$ 45,526,087	$ 72,544,442	$ 72,544,442
Securities Held for Maturity	-	-	-	-	-	54,892,115	55,893,074
Loans, Net	1,078,394,812	-	-	1,079,218,425	1,079,218,425	897,726,471	900,157,044
Bank Owned Life Insurance	27,484,406	-	27,484,406	-	27,484,406	26,663,318	26,663,318
Financial Liabilities							
Non-Interest Bearing Deposits	$ 330,218,494	$ -	$ 330,218,494	$ -	$ 330,218,494	$ 305,042,279	$ 305,042,279
Interest Bearing Transaction Accounts	721,076,125	-	721,076,125	-	721,076,125	651,611,854	651,611,854
Time Deposits	210,873,421	-	-	212,436,041	212,436,041	225,949,151	224,241,827
Other Borrowed Funds	21,494,009	-	21,737,263	-	21,737,263	21,629,820	22,509,203
Fed Funds Purchased and Repurchase Agreements	10,531,931	-	10,531,931	-	10,531,931	7,874,545	7,874,545

NOTE 26 SUBSEQUENT EVENTS

On January 2, 2015, the Company acquired Interactive Retirement Solutions, Ltd., located in Bloomington, Minnesota. The purchased assets and assumed liabilities were recorded at their respective acquisition date fair values, and identifiable intangible assets were recorded at fair value. The purchase, consisting of approximately 160 retirement plans with more than 16,200 retirement participants, grew the Company's wealth management division by $1.25 billion in retirement and individual assets managed accounts. As part of the transaction, $4.5 million was allocated to an identified customer intangible.

Subsequent events have been evaluated through March 31, 2015, which is the date these financial statements were available to be issued.