BEO BANCORP

2014 Annual Report

BEO Bancorp and Subsidiary

Consolidated Financial Statements

With Independent Auditors’ Report

Years Ended December 31, 2014 and 2013

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BEO BANCORP

P.O. BOX 39 Heppner, OR 97836 Administrative Office: 279 N. Main Heppner, OR 97836 Phone: (541) 676-0201

Message to our stockholders

I am pleased to present to you the financial statements and operating results of BEO Bancorp and Bank of Eastern Oregon for 2014. The results show a decrease in profitability when compared to 2013, but are similar to 2012.

As we look back at 2014, the agricultural economy was somewhat of a mixed bag. Dry weather conditions across much of our trade area hindered production. Grain prices were down from the past few years, hay prices were steady and cattle prices charted new high points.

2014 also saw your Bank announce an agreement to acquire Bank Reale in Pasco, WA. This is our first branch outside of Oregon. We see it as a natural step towards a strong presence in southeastern Washington.

Consolidated after tax net income for BEO Bancorp in 2014 was $2,419,000; down 9.5% from 2013. The lower profitability figures for 2014 are caused by primarily 2 factors: 1) expenses associated with the Bank Reale acquisition and 2) an increased loan loss reserve provision. This step was necessary to address a few problem loans, position ourselves for anticipated loan growth, and be prepared for the cyclical nature of agricultural lending. Return on Average Assets (ROAA) for 2014 was 0.77% compared to 0.92% in 2013. While the level is down from last year the primary driver is significant growth in total assets. We have experienced strong increase in deposits and a rate environment that dictates excess liquidity remains within the bank. This is good for liquidity, but negatively impacts ROAA. Return on Average Equity is at 10.10% compared to 12.55% in 2013. We see similar trends across the banking industry, which is a function of the stagnant rate environment. Net earnings per share were $2.09 in 2014 compared to $2.54 in 2013. This decrease was impacted by an increased number of outstanding shares.

Your Bank continues to experience managed growth. Stockholders' equity grew from $22,930,000 to $24,951,000; an increase of 8.8%. Total assets were at $325,898,000 up 9.0% year over year; deposits set another all-time high of $291,833,000 up 10.1% from 2013. Net loans increased 4.4% to $250,383,000 also a high point for the Bank. I see these factors as being indicative of the trust and loyalty that our customers place in your Bank. This trust does not happen by accident. We have a talented and experienced team of bankers that strive daily to meet and exceed the expectations of our customers. I thank them for their efforts.

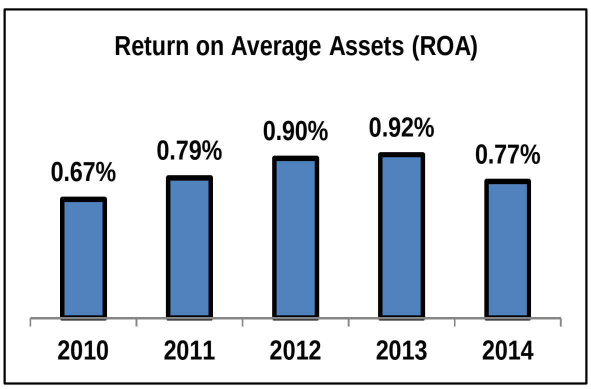
As shareholders, thank you for your continued investment and confidence in BEO Bancorp. I cordially invite you to attend our annual meeting of shareholders. We will provide a recap of 2014, elect three directors and offer a glimpse at what we expect in 2015. We will meet **Tuesday, April 28, 2014 at 7:00 pm** at the Sage Center, 101 Olson Road in Boardman, OR.

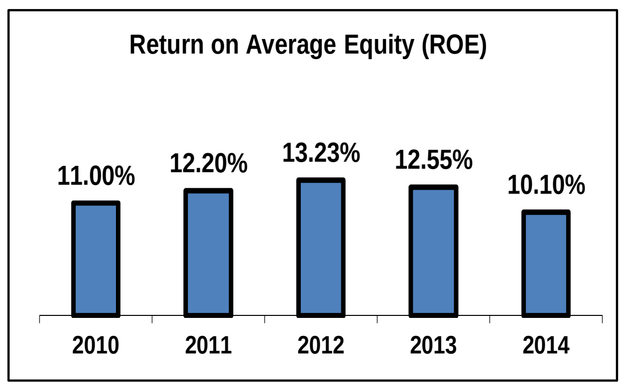
Sincerely,

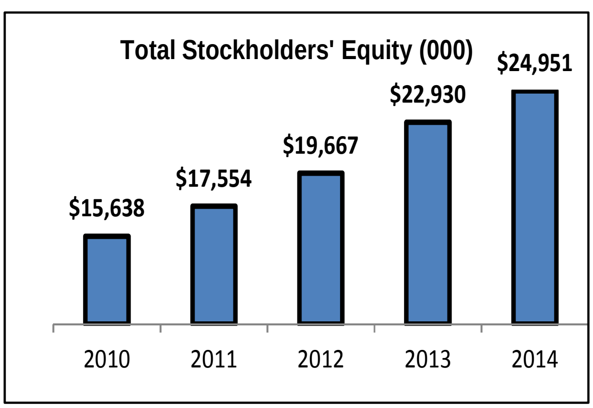
Jeff L. Bailey
President and CEO
BEO Bancorp

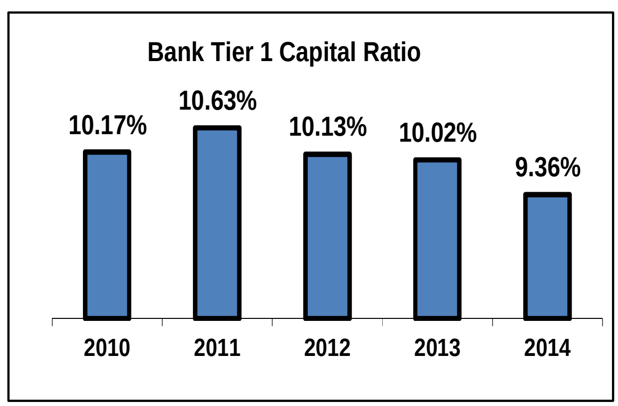
FINANCIAL HIGHLIGHTS
2010-2014

	2010	2011	2012	2013	2014
Return on Average Assets	0.67%	0.79%	0.90%	0.92%	0.77%
Return on Average Equity	11.00%	12.20%	13.23%	12.55%	10.10%
Net Income	$1,656,016	$2,011,567	$2,461,996	$2,673,600	$2,418,590
Net Income Per Share	$1.80	$2.18	$2.55	$2.54	$2.09
Total Equity (000)	$15,638	$17,554	$19,667	$22,930	$24,951
Total Assets (000)	$251,734	$260,437	$284,848	$299,084	$325,898
Bank Tier 1 Capital Ratio	10.17%	10.63%	10.13%	10.02%	9.36%









Board of Directors

Gary Neal, Chairman
General Manager

E. George Koffler, Vice Chairman
Retired Banker

Brad Anderson
Farmer/Rancher

Robert M. Armstrong
Certified Public Accountant

Jeff Bailey
President and CEO

Linda LaRue
Retired Banker

Joel Peterson
Farmer

Executive Officers

Jeff Bailey
President & CEO

Mark Lemmon
Executive Vice President & CFO

Gary Propheter
Executive Vice President & COO

Senior Vice Presidents

Becky Kindle
Senior Vice President
Branch Administrator

John Qualls
Senior Vice President
Senior Loan Officer

Ed Rollins
Senior Vice President
Credit Administrator

Vice Presidents

John Bailey
Loan Officer

Janet Dezellem
Controller

James Gardner
Loan Officer

Tricia Gunderson
HR Manager

Dan McNeley
Loan Officer

Jill Parker
Loan Officer

Robert Quinton
Loan Officer

Robert Williams
Loan Officer

Assistant Vice Presidents

Christy Correa
Finance Coordinator

Karen Cossitt
Fossil Manager

Dawna Dougherty
Compliance Officer

Justin Miller
Loan Officer

Joyce Moser
Mortgage Specialist

Janice Provencher
John Day Manager

Rhonda Shaffer
Loan Officer

Jennifer Smith
Moro Manager

Lenders and Managers

Jim Bleth
IS Manager

Arletta Arnspiger
Mortgage Manager

Kathy Burres
Condon Manager

Jolene Cox
Enterprise Manager

Julie Gisi
Boardman Manager

Susan Jones
Arlington Manager

Sherrie Modey
Burns Manager

Andrea Moles
Prairie City Manager

Citlali Mendoza
Irrigon Manager

Sharon Rietmann
Ione Manager

Tricia Rollins
Heppner Manager

Mike Allen
Loan Officer

Nial Bradshaw
Loan Officer

Tristan Henke
Loan Officer

Laura Isaacson
Loan Officer

Jed Myers
Loan Officer

Joe Perry
Loan Officer

Kristy Perry
Loan Officer

Cori Price
Loan Officer

Russell Seewald
Loan Officer

Mike Short
Loan Officer

ISLER CPA
CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS ADVISORS

An Independently Owned Member MCGLADREY ALLIANCE | McGladrey

Independent Auditor's Report

To the Board of Directors
BEO Bancorp:

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of BEO Bancorp and Subsidiary ("BEO") which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, profit and other comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the 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.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits 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 consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

Opinion
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BEO as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Isler CPA, LLC

March 13, 2015

1976 Garden Ave., Eugene, OR 97403
541-342-5161 www.islercpa.com

BEO Bancorp and Subsidiary
Consolidated Balance Sheets

	December 31	
	2014	**2013**
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	**$ 7,509,405**	$ 2,891,930
Interest bearing deposits at other financial institutions	**33,475,204**	20,449,706
Total cash and cash equivalents	**40,984,609**	23,341,636
Investment securities available-for-sale	**13,108,009**	14,632,026
Investment securities held-to-maturity	**4,250,462**	4,681,623
Loans, less allowance for loan losses	**250,382,990**	239,823,302
Interest receivable	**3,069,856**	3,009,570
Federal Home Loan Bank stock	**509,800**	530,300
Property, less accumulated depreciation	**7,326,769**	6,716,956
Deferred taxes, net	**706,363**	698,607
Foreclosed assets	**328,310**	114,122
Cash surrender value of bank owned life insurance	**4,560,336**	4,433,312
Other assets	**670,082**	1,102,191
	284,912,977	275,742,009
Total assets	**$ 325,897,586**	$ 299,083,645
LIABILITIES and STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing demand	**$ 75,158,049**	$ 64,100,671
Savings and interest-bearing demand	**167,035,941**	147,429,401
Time, $100,000 and over	**12,572,229**	12,742,216
Other time	**37,066,553**	40,679,401
	291,832,772	**264,951,689**
Subordinated debentures	**7,217,000**	8,690,750
Interest payable	**56,404**	72,003
Other liabilities	**1,840,627**	2,438,844
Total liabilities	**300,946,803**	276,153,286
Stockholders' equity:		
Common stock, $5 par value, 3,000,000 shares authorized 1,187,321 outstanding December 31, 2014, 1,090,955 outstanding December 31, 2013	**3,767,600**	3,253,130
Additional paid-in capital	**2,625,735**	2,245,027
Retained earnings	**18,786,642**	17,080,745
Treasury stock at cost, 6,528 shares	**(156,228)**	-
Accumulated other comprehensive income (loss)	**(72,966)**	351,457
Total stockholders' equity	**24,950,783**	22,930,359
Total liabilities and stockholders' equity	**$ 325,897,586**	$ 299,083,645

The accompanying notes are an integral part of these consolidated financial statements.

BEO Bancorp and Subsidiary

Consolidated Statements of Income

	Year Ended December 31	
	2014	**2013**
Interest income:		
Interest and fees on loans:		
Taxable	**$14,403,688**	$14,385,693
Nontaxable	**299,230**	344,660
Interest on investment securities:		
Taxable	**197,329**	233,585
Nontaxable	**245,847**	270,793
Interest on federal funds sold and short-term time deposits	**46,249**	57,480
	15,192,343	15,292,211
Interest expense	**997,442**	1,183,698
Net interest income	**14,194,901**	14,108,513
Provision for loan losses	**1,300,000**	1,210,000
Net interest income after provision for loan losses	**12,894,901**	12,898,513
Noninterest income:		
Service charges	**1,730,189**	1,628,349
Mortgage banking income	**253,322**	240,538
Other	**150,669**	304,855
	2,134,180	2,173,742
Noninterest expense:		
Salaries and employee benefits	**7,006,945**	6,743,211
Occupancy expense	**658,153**	639,998
Equipment expense	**985,072**	811,045
Foreclosed asset expenses	**51,659**	369,725
Other	**2,901,662**	2,741,676
	11,603,491	11,305,655
Income before income taxes	**3,425,590**	3,766,600
Provision for income taxes	**1,007,000**	1,093,000
Net income	**$ 2,418,590**	$ 2,673,600
Basic earnings per share	**$ 2.09**	$ 2.54
Diluted earnings per share	**$ 2.09**	$ 2.39

The accompanying notes are an integral part of these consolidated financial statements.

BEO Bancorp and Subsidiary
Consolidated Statements of Profit and Other Comprehensive Income

	Year Ended December 31	
	2014	**2013**
Net Income	**$ 2,418,590**	$ 2,673,600
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on investment securities	**122,508**	(319,254)
Unrealized gain (loss) on cash flow hedge instrument	**(546,931)**	478,844
Other comprehensive income (loss)	**(424,423)**	159,590
Comprehensive Income	**$ 1,994,167**	$ 2,833,190

The accompanying notes are an integral part of these consolidated financial statements.

BEO Bancorp and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2014 and 2013

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, January 1, 2013	$ 2,661,105	$ 1,806,927	$ 15,007,170	$ 191,867		$19,667,069
Issuance of 118,405 shares	592,025	438,100				1,030,125
Net income			2,673,600			2,673,600
Other comprehensive income (loss):				159,590		159,590
Cash dividends ($.55 per share)			(600,025)			(600,025)
Balance, December 31, 2013	3,253,130	2,245,027	17,080,745	351,457	-	22,930,359
Issuance of 102,894 shares	**514,470**	**380,708**				**895,178**
Net income			**2,418,590**			**2,418,590**
Other comprehensive income (loss):				**(424,423)**		**(424,423)**
Purchase of 6,528 shares of treasury stock					**(156,228)**	**(156,228)**
Cash dividends ($.60 per share)			**(712,693)**			**(712,693)**
Balance, December 31, 2014	**$ 3,767,600**	**$ 2,625,735**	**$ 18,786,642**	**$ (72,966)**	**$ (156,228)**	**$24,950,783**

The accompanying notes are an integral part of these consolidated financial statements.

BEO Bancorp and Subsidiary
Consolidated Statements of Cash Flows

	Year Ended December 31	
	2014	**2013**
Cash flows from operating activities:		
Net income	**$ 2,418,590**	$ 2,673,600
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**538,591**	455,647
Net gains or losses on property dispositions	**10,968**	(94,935)
Amortization of investment premiums, net	**76,693**	103,252
Amortization of core deposit intangible	**-**	131,267
Provision for loan losses	**1,300,000**	1,210,000
Write down of foreclosed assets	**22,825**	351,560
Increase in cash value of life insurance	**(127,024)**	(136,042)
Deferred income taxes	**293,000**	(73,000)
Change in:		
Interest receivable and other assets	**(189,459)**	729,949
Deferred loan fees	**5,270**	120,168
Accrued interest and other liabilities	**(963,331)**	749,036
Net cash provided by operating activities	**3,386,123**	6,220,502
Cash flows from investing activities:		
Proceeds from maturities of investment securities	**8,308,798**	5,178,108
Purchase of investment securities	**(6,244,695)**	(5,683,381)
Proceeds from sale of foreclosed assets	**281,175**	545,904
Proceeds from sale of FHLB stock	**20,500**	19,600
Loans originated, net of principal collected	**(12,386,401)**	(16,426,946)
Purchases of property	**(1,156,117)**	(502,632)
Net cash provided (used) in investing activities	**(11,176,740)**	(16,869,347)
Cash flows from financing activities:		
Net increase in deposits	**26,881,083**	12,063,907
Reduction of subordinated debt	**(1,473,750)**	(1,605,000)
Issuance of common stock	**895,178**	1,030,125
Repurchase of common stock	**(156,228)**	-
Dividends paid	**(712,693)**	(600,025)
Net cash provided by financing activities	**25,433,590**	10,889,007
Net increase (decrease) in cash and cash equivalents	**17,642,973**	240,162
Cash and cash equivalents, beginning of year	**23,341,636**	23,101,474
Cash and cash equivalents, end of year	**$ 40,984,609**	$ 23,341,636

The accompanying notes are an integral part of these consolidated financial statements.

BEO Bancorp and Subsidiary
Consolidated Statements of Cash Flows, Continued

	Year Ended December 31	
	2014	**2013**
Supplemental information:		
Cash paid during the year for:		
Income taxes	**$ 1,540,000**	$ 600,000
Interest	**1,013,041**	1,201,468
Transfer of loans to foreclosed assets	**521,443**	49,722

The accompanying notes are an integral part of these consolidated financial statements.

1. Summary of Significant Accounting Policies:

Basis of Presentation – The consolidated financial statements include the accounts of BEO Bancorp ("Bancorp"), a bank holding company, and its wholly-owned subsidiary, Bank of Eastern Oregon (the "Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation. Bancorp has also established subsidiary grantor trusts in connection with the issuance of trust preferred securities (see Note 11). In accordance with the requirements of ASC 810 the accounts and transactions of these trusts are not consolidated in the accompanying consolidated financial statements.

Description of Business - The Bank provides commercial and consumer financing, banking and mortgage lending and other services in Northeastern Oregon. Its activities include the usual lending and deposit functions of a commercial bank: commercial, agricultural, real estate, installment, credit card and mortgage loans; checking, money market, time deposit and savings accounts; internet banking and bill payment; automated teller machines and safe deposit facilities. Additionally, the Bank originates and sells mortgage loans into the secondary market.

Financial Statement Presentation – The preparation of the financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect reported amounts and related disclosures, and actual results could differ from those estimates. The most significant estimates are the allowance for loan losses and fair value estimates. The Company has evaluated subsequent events through March 13, 2015, the date the financial statements are available for distribution. Certain prior year amounts may have been reclassified to conform to the current year presentation. Such reclassifications have no effect on previously reported net income.

Cash and Cash Equivalents – For purposes of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "cash and due from banks". Such amounts include interest bearing deposits and federal funds sold on a short-term basis and may exceed amounts insured by FDIC.

Investment Securities – Securities for which management has the positive intent and ability to hold to maturity are classified as held-to-maturity and are reported at cost adjusted for remaining balances of premiums or discounts.

Securities purchased with the intent to sell in the near term are classified as trading securities and are reported at estimated fair market value with unrealized gains or losses reported in non-interest income. The Bank had no trading securities at December 31, 2014 or 2013.

1. Summary of Significant Accounting Policies, Continued:

Securities not classified as held-to-maturity or as trading securities are classified as available-for-sale. Securities available-for-sale are held for indefinite periods of time and may be sold in response to changes in market interest rates, shifts in the maturity mix or concentration of bank assets or liabilities or to alleviate liquidity demands. Securities designated as available-for-sale are carried at estimated fair value. Unrealized gains and losses are excluded from earnings and are credited or charged to other comprehensive income in stockholders' equity, net of applicable deferred taxes. Interest income on debt securities is included in income using the effective interest method. Gains and losses realized on sales of securities are recognized on the specific identification method.

The Bank recognizes other-than-temporary impairments for debt securities classified as available for sale in accordance with ASC 320. Accordingly, the Bank assesses whether it intends to sell, or it is more likely than not that it will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that the Bank does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the Bank separates the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows discounted at the security's effective yield. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and, therefore, is not required to be recognized as losses in the income statement, but is recognized in other comprehensive income. The Bank has not recognized an other-than-temporary impairment of its debt securities as management believes all unrealized losses on investment securities at December 31, 2014 are temporary (see note 3).

Loans and Income Recognition – Loans are stated at the amount of unpaid principal, net of deferred loan origination fees, premiums or discounts on purchased loans, and an allowance for loan losses. Interest on loans is calculated using the simple-interest method on daily balances of the principal amount outstanding. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that collection of the interest is doubtful. Cash receipts on non-accrual loans are first recorded as principal collections. Loan origination fees, net of associated direct costs, if significant, are amortized by the interest method over the contractual life of the loan. Premiums and discounts on loans purchased are amortized using the straight line method over a period management believes best matches the cash flow and risks associated with the loan.

1. **Summary of Significant Accounting Policies,** Continued:

Allowance for Loan Losses – The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance is an amount that management considers adequate to absorb possible losses on existing loans that may become uncollectible based on evaluations of the collectability of loans and prior loss experience. The evaluations take into consideration such factors as changes in the nature and value of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay.

A loan is considered impaired when management believes that it is probable that all amounts will not be collected according to the contractual terms. An impaired loan is valued using the present value of expected cash flows discounted at the loan's effective interest rate, the observable market price of the loan or the estimated fair value of the loan's collateral or related guaranty. Loans deemed impaired have a specifically allocated reserve within the allowance for loan losses.

The allowance and provision are estimates that are necessarily subjective and may be adjusted as more current information becomes available. Any adjustment could be significant.

The Bank classifies reserves for potential losses on commitments to loan in other liabilities.

Federal and state bank regulatory agencies, as an integral part of their examination process, periodically review the Bank's reserve for loan losses. Such agencies may require the Bank to recognize additions to the reserve in the future based on their judgment of the information available to them at the time of their examinations.

Federal Home Loan Bank Stock – The investment in Federal Home Loan Bank ("FHLB") stock is a restricted investment carried at cost, which is based on the ultimate recoverability at par value. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock based on borrowings. At December 31, 2014, the minimum required investment was $101,200. The Bank may request redemption at par value of any stock in excess of the amount it is required to hold. Stock redemptions are at the discretion of the FHLB.

Property – Property is stated at cost, net of accumulated depreciation. Additions, betterments and replacements of major units are capitalized. Expenditures for normal maintenance, repairs and replacements of minor units are charged to expense as incurred. Gains or losses realized from sales or retirements are reflected in operations currently. Depreciation is computed by the straight-line method over the estimated useful lives of the assets.

1. Summary of Significant Accounting Policies, Continued:

Core Deposit Intangible – Core deposit intangible is stated at cost, net of accumulated amortization. Amortization is recorded on an accelerated basis through 2013, with periodic evaluation for impairment.

Foreclosed Assets – Assets acquired through, or in lieu of, loan foreclosure are held-for-sale and are initially recorded at fair value at the date of foreclosure based on current appraisals, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense.

Advertising – Advertising costs are generally charged to expense during the year in which they are incurred.

Income Taxes – Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are calculated on differences between financial statement and tax bases of assets and liabilities using tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established to reduce the net carrying amount of deferred tax assets if it is determined to be more likely than not, that all or some of the potential deferred tax asset will not be recognized.

Uncertain tax positions are accounted for in accordance with ASC 740 which prescribes recognition and measurement standards for uncertain income tax positions. The Standard provides guidance on recognition, de-recognition, interest, penalties and disclosure. There is no material impact of potential tax uncertainties on Bancorp’s financial condition or results of operations at December 31, 2014. Tax returns for years subsequent to 2010 remain open to examination by these taxing jurisdictions.

Fair Value – Bancorp applies the hierarchy and framework for measuring fair value, disclosure about fair value measurements and the reliability of valuation inputs as provided in ASC 820. When determining the fair value, Bancorp considers the transaction to sell an asset or transfer a liability occurs in the most advantageous market for that asset or liability. Within the hierarchy, Level 1 instruments use observable market prices for the identical item in active markets and have the most reliable valuations. Level 2 instruments are valued through broker/dealer quotation or through market-observable inputs for similar items in active markets, including forward and spot prices, interest rates and volatilities. Level 3 instruments are valued using inputs not observable in an active market such as company-developed future cash flow estimates, and are considered the least reliable. Valuations for all of Bancorp’s and the Bank’s financial instruments fall within Levels 2 and 3.

1. Summary of Significant Accounting Policies, Continued:

Derivative Instruments – Bancorp and the Bank use a derivative financial instrument (interest rate swaps) to limit exposure to changes in interest rates related to a subordinated debenture. The derivatives entered into by Bancorp and the Bank are designated as cash flow hedge with perfect effectiveness between changes in the value of the interest rate swap and the hedged instrument (subordinated debenture liability). The derivative and related hedged debenture are recognized in the balance sheet at their fair value. Bancorp and the Bank formally documents all relationships between hedging instruments and formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative that is used in the hedging transaction is highly effective in offsetting changes in fair values of hedged items.

Bancorp and the Bank would discontinue hedge accounting when: (a) it is determined that a derivative is no longer effective in offsetting changes in the fair value of the associated hedged item; (b) the derivative expires or is sold, terminated, or exercised; or (c) management determines that designation of the derivative as a hedge instrument is no longer appropriate. The hedged liability would no longer be adjusted for changes in fair value and the derivative would be carried at its fair value in the balance sheet, with changes in its fair value recognized in current-period earnings.

Recently Issued Accounting Pronouncements Adopted in 2014:

FASB Accounting Standard Update No. ASU 2012-04, *Technical Corrections and improvements.* This ASU clarifies the Codification or corrects unintended applications of guidance that are not expected to have a significant effect on current accounting practice or create a significant administrative cost. This update is effective for the Bank for the year ended December 31, 2014.

FASB Accounting Standard Update No. ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The objective of this Update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this Update seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAS) to be reclassified in its entirety to net income. This update is effective for the Bank for the year ended December 31, 2014.

FASB Accounting Standard Update No. ASU 2014-07, *Technical Corrections and Improvements Related to Glossary Terms.* -These amendments relate to glossary terms and cover a wide range of Topics in the Codification. These amendments are presented in four sections: 1) Deletion of Master Glossary Terms arising because of terms that were carried forward from source literature to the Codification but were not utilized in the Codification; 2) Addition of Master Glossary Term

1. Summary of Significant Accounting Policies, Continued:

Links arising from Master Glossary terms whose links did not carry forward to the Codification; 3) Duplicate Master Glossary Terms arising from Master Glossary terms that appear multiple times in the Master Glossary with similar, but not identical, definitions; and 4) Other Technical Corrections Related to Glossary Terms arising from miscellaneous changes to update Master Glossary terms. Implemented in 2014.

Recently Issued Accounting Pronouncements Effective in 2015 and subsequent years:

FASB Accounting Standard Update No. ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.* These amendments provide that an unrecognized tax benefit, or a portion thereof, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. This update is effective for the Bank for the year ended December 31, 2015.

FASB Accounting Standard Update No. ASU 2014-02, *Intangibles—Goodwill and Other (Topic 350)—Accounting for Goodwill.* " These amendments permit a private company to subsequently amortize goodwill on a straight-line basis over a period of ten years, or less if the company demonstrates that another useful life is more appropriate. It also permits a private company to apply a simplified impairment model to goodwill. Under the goodwill accounting alternative, goodwill should be tested for impairment when a triggering event occurs that indicates that the fair value of a company (or a reporting unit) may be below its carrying amount. A private company that elects the accounting alternative is further required to make an accounting policy election to test goodwill for impairment at either the company level or the reporting unit level. This update is effective for the Bank for the year ended December 31, 2015.

FASB Accounting Standard Update No. ASU 2014-04, *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40)—Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* These amendments are intended to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized. These amendments clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon certain conditions This update is effective for the Bank for the year ended December 31, 2015.

1. **Summary of Significant Accounting Policies,** Continued:

FASB Accounting Standard Update No. ASU 2014-11. *Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures.* The amendments in ASU 2014-11 align the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement, which has resulted in outcomes referred to as off-balance-sheet accounting. ASU 2014-11 also brings U.S. GAAP into greater alignment with IFRS for repurchase-to-maturity transactions. This update is effective for the Bank for the year ended December 31, 2015.

FASB Accounting Standard Update No. ASU 2014-12. *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period.* The amendments in ASU 2014-12 require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, Compensation – Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. This update is effective for the Bank for the year ended December 31, 2016.

FASB Accounting Standard Update No. ASU 2014-14. *Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure.* 'The amendments in ASU 2014-14 affect creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA. It requires that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if the certain conditions are met. This update is effective for the Bank for the year ended December 31, 2016.

The Bank is evaluating the impact that these amendments have on future financial statements.

2. Cash and Due From Banks:

The Bank is required to maintain an average reserve balance with the Federal Reserve Bank or maintain such reserve balance in the form of cash. The required reserve balances at December 31, 2014 and 2013 were approximately $6,047,000 and $456,000, respectively, and were met by holding cash and maintaining an average balance with the Federal Reserve Bank.

3. Investment Securities:

The amortized cost and estimated fair values of investment securities at December 31, 2014 and 2013 are as follows:

2014

Available-for-sale:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government agencies	$ 5,248,918	$ 26,017	$ (51,547)	$ 5,223,388
Government guaranteed loan pools	4,421,920	167,922	(6,255)	4,583,587
Mortgage-backed securities	695,054	826	(4,261)	691,619
Obligations of municipal entities	2,534,931	74,484	-	2,609,415
	$ 12,900,823	$ 269,249	$ (62,063)	$ 13,108,009

Held-to-maturity:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of municipal entities	$ 4,250,462	$ -	$ -	$ 4,250,462
	$ 4,250,462	$ -	$ -	$ 4,250,462

2013

Available-for-sale:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government agencies	$ 5,748,109	$ 15,079	$ (204,535)	$ 5,558,653
Government guaranteed loan pools	5,414,040	202,146	(3,987)	5,612,199
Mortgage-backed securities	828,495	899	(10,641)	818,753
Obligations of municipal entities	2,619,813	31,922	(9,314)	2,642,421
	$ 14,610,457	$ 250,046	$ (228,477)	$ 14,632,026

Held-to-maturity:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of municipal entities	$ 4,681,623	$ -	$ -	$ 4,681,623
	$ 4,681,623	$ -	$ -	$ 4,681,623

3. Investment Securities, Continued:

Investment securities that were in unrealized loss positions as of December 31, 2014 and 2013 are presented in the following tables, based on the length of time that individual securities were in unrealized loss positions.

Securities in Unrealized Loss Positions as of December 31, 2014

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Obligations of U.S. Government agencies	**$ 1,990,410**	**$ (4,143)**	**$ 1,202,596**	**$ (47,404)**	**$ 3,193,006**	**$ (51,547)**
Mortgage-backed securities	**-**	**-**	**678,117**	**(4,261)**	**678,117**	**(4,261)**
Government guaranteed loan pools	**184,577**	**(664)**	**556,970**	**(5,591)**	**741,547**	**(6,255)**
Obligations of municipal entities	**-**	**-**	**-**	**-**	**-**	**-**
Total	**$ 2,174,987**	**$ (4,807)**	**$ 2,437,683**	**$ (57,256)**	**$ 4,612,670**	**$ (62,063)**

Securities in Unrealized Loss Positions as of December 31, 2013

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government agencies	**$ 2,906,641**	**$ (89,518)**	**$ 634,983**	**$ (115,017)**	**$ 3,541,624**	**$ (204,535)**
Mortgage-backed securities	**802,702**	**(10,641)**	**-**	**-**	**802,702**	**(10,641)**
Government guaranteed loan pools	**632,083**	**(2,825)**	**218,887**	**(1,161)**	**850,970**	**(3,986)**
Obligations of municipal entities	**-**	**-**	**265,352**	**(9,314)**	**265,352**	**(9,314)**
Total	$ 4,341,426	$ (102,984)	$ 1,119,222	$ (125,492)	$ 5,460,648	$ (228,476)

The unrealized losses on investment securities were caused by interest rate increases subsequent to the purchase of the securities and are considered temporarily impaired. It is expected that the securities will not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Bank has the ability and intent to hold these investments until a market price recovery or to maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

3. Investment Securities, Continued:

The amortized cost and estimated fair value of investment securities at December 31, 2014 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 937,352	$ 938,344	$ 447,848	$ 447,848
Due after one year through five years	4,331,282	4,403,469	1,977,810	1,977,810
Due after five years	6,937,135	7,074,577	1,824,804	1,824,804
Mortgage-backed securities	695,054	691,619	-	-
	$ 12,900,823	$ 13,108,009	$ 4,250,462	$ 4,250,462

There were no sales of securities in 2014 or 2013.

At December 31, 2014, investment securities with amortized costs of $10,176,691and estimated fair values of $10,384,284 were pledged for public deposits ($9,890,482 and $9,921,681 in 2013, respectively).

4. Loans:

Major classifications of loans by type of collateral at December 31 are as follows:

	2014	2013
Farmland Loans	**$ 77,889,416**	$ 71,534,732
Commercial real estate loans	**53,089,613**	57,958,472
Agriculture loans	**43,589,695**	40,863,242
Government guaranteed loans	**19,017,136**	23,119,290
Commercial loans	**29,792,241**	23,788,181
Real estate loans	**22,223,264**	16,665,624
Municipal loans	**6,529,527**	7,158,630
Consumer loans	**2,836,083**	2,980,536
	254,966,975	244,068,707
Deferred loan origination fees	**(650,581)**	(645,311)
	254,316,394	243,423,396
Allowance for loan losses	**(3,933,404)**	(3,600,094)
	$ 250,382,990	$ 239,823,302

The loan portfolio at December 31, 2014 and 2013 includes $205,353,195 and $189,878,071, respectively, of loans which have a variable rate of interest. The December 31, 2014 amount includes $195,395,953 of loans with interest rates at their contractual floors.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of such serviced loans was $6,130,394 and $3,744,377 at December 31, 2014 and 2013, respectively.

The total loans outstanding on December 31 which were on a nonaccrual basis, contractually past due 90 days or more as to interest or principal payments are as follows:

	Recorded Investment Nonaccrual Loans	Unpaid Principal Nonaccrual Loans	Loans Past Due 90 Days or More and Still Accruing
2014			
Farmland	**$ 4,456,396**	**$ 4,456,396**	**$ -**
Commercial real estate	**2,406,431**	**2,506,932**	**-**
Agriculture	**3,747,763**	**3,747,763**	**-**
Commercial	**694,503**	**797,899**	**-**
Real estate	**635,261**	**881,237**	**-**
	$11,940,354	**$12,390,227**	**$ -**
2013			
Farmland	$ 178,116	$ 178,116	$ -
Commercial real estate	2,943,164	3,020,635	-
Agriculture	92,154	92,154	17,658
Commercial	1,381,924	1,381,924	-
Real estate	74,478	151,867	-
	$ 4,669,836	$ 4,824,696	$ 17,658

4. **Loans,** Continued:

The following is an analysis of impaired loans as of December 31:

2014	**Impaired Loans**				
	With a Related Allowance	**Without a Related Allowance**	**Total Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
Farmland	**$3,275,016**	**$1,181,380**	**$ 4,456,396**	**$ 4,456,396**	**$ 421,544**
Commercial real estate	**-**	**2,470,989**	**2,470,989**	**2,571,490**	**-**
Agriculture	**3,744,125**	**3,638**	**3,747,763**	**3,747,763**	**1,528,050**
Commercial	**-**	**694,503**	**694,503**	**797,899**	**-**
Real estate		**830,789**	**830,789**	**1,076,765**	**-**
	$7,019,141	**$5,181,299**	**$12,200,440**	**$12,650,313**	**$1,949,594**

2013	Impaired Loans				
	With a Related Allowance	Without a Related Allowance	Total Recorded Investment	Unpaid Principal Balance	Related Allowance
Commercial real estate	$ 766,409	$2,944,436	$ 3,710,845	$ 4,038,145	$ 61,571
Agriculture	-	8,700	8,700	8,700	-
Commercial	1,070,636	311,288	1,381,924	1,382,479	669,006
Real estate	-	127,715	127,715	205,492	-
	$1,837,045	$3,392,139	$ 5,229,184	$ 5,634,816	$ 730,577

The average recorded investment in impaired loans was approximately $7,743,415 and $5,452,214 in 2014 and 2013, respectively. Interest income recognized on impaired loans totaled $14,316 and $150,647 in 2014 and 2013, respectively. Interest income which would have been realized on non-accrual loans if they had remained current and still accruing was $735,652 and $233,564 in 2014 and 2013, respectively.

4. Loans, Continued:

There were no loans accounted for as Trouble Debt Restructurings (TDR) that occurred during the years ended December 31, 2014 and 2013.

None of the loans accounted for as TDR were in default as of December 31, 2014. At December 31, 2014 the Bank had no unfunded commitments on TDR loans. There were $36,956 unfunded commitments on TDR loans at December 31, 2013. Loans are accounted for as TDR when significant concessions have been granted that would not have otherwise been considered except for the borrower's financial difficulties. Concessions may include extended repayment terms such as interest only payments or lengthened maturities, or interest rate modifications and are granted to improve the likelihood that the borrower will be able to repay the obligation. TDR loans are included in impaired loans and the methodology for evaluating credit losses and accrual status is the same as for other impaired loans.

5. Allowance for Loan Losses:

The Bank maintains an allowance for loan losses ("ALLL") to absorb losses resulting from the inherent risks of lending. The balance of the ALLL is reviewed at least quarterly to assess the adequacy relative to probable estimated losses within the loan portfolio. The methodology is consistent with the Contingencies and Receivables topics of the FASB ASC and did not significantly change during 2014 or 2013. The ALLL includes a general allowance based on quantitative and qualitative factors on non-impaired loans plus specific reserves on impaired loans established to account for credit attributes of the individual relationships. Credit risk is managed through established policies and procedures including lending limits, diversification, approval requirements, and an ongoing comprehensive review process. The review process includes assigning a numerical risk rating to a loan when originated, and then modifying that risk rating as circumstances dictate.

These Loan risk ratings are assigned as follows:

A rating of 1-2 indicates low apparent credit risk.
A rating of 3-4 indicates average to above average potential credit risk.
A rating of 5-6 indicates weaknesses and factors displaying potential credit risk that requires a higher level of management attention.
A rating of 7 indicates a probable loss but the amount is not specifically determined.
A rating of 8 indicates specific loss has been identified and charge-off is imminent.

5. Allowance for Loan Losses, Continued:

A detailed analysis of the ALLL by major portfolio segment as of December 31:

2014			**Allowance for Loan Losses**					
	Weighted Average Risk Rating	**Recorded Investment in Loans**	**Beginning Balance**	**Net (Charge-off) Recovery**	**Provision**	**Ending Balance**	**Specific Reserve**	**General Allocation**
Farmland	**2.95**	**$ 77,635,459**	**$ 457,497**	**$ 60,047**	**$ 20,000**	**$ 537,544**	**$ 421,544**	**$ 116,000**
Commercial real estate	**2.78**	**52,958,598**	**1,558,213**	**(288,180)**	**20,000**	**1,290,033**	**-**	**1,290,033**
Agriculture	**2.89**	**43,581,661**	**505,276**	**-**	**1,190,000**	**1,695,276**	**1,528,050**	**167,226**
Government guaranteed	**1.54**	**18,998,015**	**17,246**	**(75,966)**	**60,000**	**1,280**	**-**	**1,280**
Commercial	**2.66**	**29,772,701**	**857,799**	**(630,793)**	**5,000**	**232,006**	**-**	**232,006**
Real estate	**3.07**	**22,141,810**	**113,337**	**(29,725)**	**4,000**	**87,612**	**-**	**87,612**
Municipal	**2.72**	**6,392,351**	**32,060**	**-**	**750**	**32,810**	**-**	**32,810**
Consumer	**3.39**	**2,835,799**	**58,667**	**(2,074)**	**250**	**56,843**	**-**	**56,843**
Total	**2.77**	**$ 254,316,394**	**$3,600,095**	**$ (966,691)**	**$1,300,000**	**$3,933,404**	**$ 1,949,594**	**$1,983,810**

2013			Allowance for Loan Losses					
	Weighted Average Risk Rating	Recorded Investment in Loans	Beginning Balance	Net (Charge-off) Recovery	Provision	Ending Balance	Specific Reserve	General Allocation
Farmland	3.08	$ 71,296,223	$ 208,070	$ 64,427	$ 185,000	$ 457,497	$ -	$ 457,497
Commercial real estate	3.15	57,820,799	1,446,528	(8,315)	120,000	1,558,213	61,571	1,496,642
Agriculture	3.24	40,857,183	360,276	-	145,000	505,276	-	505,276
Government guaranteed	1.67	23,092,824	17,246	-	-	17,246	-	17,246
Commercial	2.96	23,776,227	223,099	500	634,200	857,799	669,006	188,793
Real estate	3.21	16,595,757	130,371	(127,035)	110,000	113,336	-	113,336
Municipal	2.72	7,004,170	25,060	-	**7,000**	32,060	-	32,060
Consumer	3.39	2,980,214	56,331	(6,464)	8,800	58,667	-	58,667
Total	2.98	$ 243,423,397	$2,466,981	$ (76,887)	$1,210,000	$3,600,094	$ 730,577	$2,869,517

6. Property:

Property at December 31 consists of the following:

	2014	2013
Land	**$ 830,150**	$ 830,150
Buildings and improvements	**7,759,721**	7,448,204
Furniture and equipment	**4,562,425**	3,916,677
	13,152,296	12,195,031
Accumulated depreciation	**(5,825,527)**	(5,478,075)
	$ 7,326,769	$ 6,716,956

Depreciation expense of $538,591 and 455,647 was recognized in the years ending 2014 And 2013, respectively.

7. Core Deposit Intangible:

The core deposit intangible was fully amortized at December 31, 2013 and amortization expense for 2013 was $131,267.

8. Other Assets:

	2014	2013
Unrealized gain on cash flow hedge instrument	**$ -**	$ 562,036
Prepaid expenses	**393,864**	306,491
Investment in unconsolidated subsidiaries (Trusts) (Note 11)	**217,000**	217,000
Capital issuance costs, net of $170,000 and $160,000 amortization in 2014 and 2013, respectively	**51,303**	10,000
Other items, net	**7,915**	6,664
	$ 670,082	$ 1,102,191

9. Deposits:

The scheduled maturities of time deposits at December 31 are as follows:

	2014	2013
Less than one year	**$ 37,702,117**	$ 41,131,452
One to three years	**8,353,085**	8,405,296
Over three years	**3,583,580**	3,884,869
	$ 49,638,782	$ 53,421,617

10. Borrowings:

At December 31, 2014, the Bank has unused credit available totaling approximately $46,500,000 from the Federal Home Loan Bank of Seattle, $20,000,000 of federal funds lines with correspondent banks and $4,800,000 with the Federal Reserve Bank of San Francisco. There were no balances outstanding on these credit lines at December 31, 2014 or December 31, 2013.

The Federal Home Loan Bank line of credit, when borrowed against, is secured by certain investment securities and real estate loans. The Federal Reserve Bank line of credit is secured by pledged real estate and agricultural loans.

11. Subordinated Debentures:

As of December 31, 2014, Bancorp had two wholly-owned trusts ("Trusts") that were formed to issue trust preferred securities and related common securities. The Trusts issued Capital Securities ("Trust Preferred Securities") and invested the proceeds in a like amount of Junior Subordinated Debentures ("Debentures") of BEO Bancorp. Interest distributions on the Trust Preferred Securities are payable quarterly and are deferrable, at Bancorp's option, for up to five years. The Debentures bear the same terms and interest rates as the related Trust Preferred Securities. The Debentures are the sole assets of the Trusts. Bancorp has unconditionally guaranteed all of the obligations of the Trusts.

The Trust Preferred Securities are mandatorily redeemable, in whole or in part, upon repayment of the underlying Debentures at their stated maturities or their earlier redemption. The Debentures are redeemable prior to maturity at Bancorp's option.

In accordance with provisions of ASC 810 the Trusts have not been consolidated in these financial statements. The $7,217,000 of Debentures issued to the Trusts as of December 31, 2014 is reflected as subordinated debentures in the consolidated balance sheets. The common stock issued by the Trusts is recorded in other assets (Note 8).

In December 2009 through March 2010 Bancorp issued a total of $4,105,000 in 7% 5-year Callable Convertible Subordinated Notes ("Notes") in a private offering with the primary purpose of providing capital to the Bank. Bancorp called portions of the Notes in three phases on February 15, 2012, May 15, 2013 and April 30, 2014 at which time the Notes were fully retired.

A summary of the terms of all outstanding subordinated debentures at December 31, 2014 is as follows:

	BEO Trust I	BEO Trust II
Amount outstanding	$4,124,000	$3,093,000
Date of original issue	December 17, 2003	March 17, 2005
Stated maturity	December 17, 2033	March 17, 2035
Interest rate	LIBOR plus 2.85%	LIBOR plus 1.90%
	(3.10% at 12/31/2014)	(2.15% at 12/31/2014)
Conversion price	N/A	N/A

12. Interest Expense:

Interest expense for the years ended December 31 is comprised of the following:

	2014	2013
Savings and interest-bearing demand	**$ 315,111**	$ 286,835
Time deposits in excess of $100,000	**143,231**	180,284
Other time deposits	**266,713**	360,566
Interest expense on deposits	**725,055**	827,685
Subordinated debentures (Note 11)	**268,548**	348,570
Short-term borrowings	**3,839**	7,443
Total interest expense	**$ 997,442**	$ 1,183,698

13. Benefit Plans:

The Bank has a defined contribution 401(k) plan and employee stock ownership plan (ESOP) that covers substantially all employees. Employer contributions are determined annually by the Board of Directors. The ESOP may use employer contributions to purchase Bancorp stock. Shares of Bancorp stock are then credited to plan participants based on annual compensation. All investments of the ESOP are held in trust for the exclusive benefit of participating employees.

Compensation for plan participants is the total eligible wages paid to participants by the Bank for each calendar year, excluding fringe benefits. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings.

Employer contributions charged to expense were $330,964 and $305,012 in 2014 and 2013, respectively. During 2014 and 2013 the plan purchased 8,209 and 7,683 shares of BEO Bancorp stock at a cumulative purchase price of $200,219 and $150,336, respectively. At December 31, 2014 the plan held 84,826 Bancorp shares, all of which were allocated to participants.

The Bank is beneficiary of bank-owned life insurance (BOLI) to support life insurance and salary continuation benefits for certain key employees. At December 31, 2014 and 2013, the Bank recorded a salary continuation benefit obligation of $949,811and $850,269, respectively. During 2014 and 2013, $72,471 and $72,471 was paid in benefits and the amount of expense charged to income was $172,013 and $166,052, respectively.

14. Income Taxes:

The provision for income taxes for the years ended December 31 consists of the following:

	2014	2013
Currently payable (refundable):		
Federal	**$ 630,000**	$1,132,985
State	**84,000**	33,015
	714,000	1,166,000
Deferred:		
Federal	**238,000**	(59,000)
State	**55,000**	(14,000)
	293,000	(73,000)
	$1,007,000	$1,093,000

The provision for income taxes results in effective tax rates less than the federal income tax statutory rate. The reasons for the differences are as follows:

	2014	2013
Tax on income at federal statutory rate (34%)	**$1,164,703**	$1,280,646
State income tax, net of federal benefit	**67,403**	21,790
Nontaxable interest income, net of allocable interest expense	**(175,898)**	(205,236)
Other, net	**(49,208)**	(4,200)
	$1,007,000	$1,093,000

14. Income Taxes, Continued:

The provision for deferred income taxes results from timing differences in the recognition of transactions for financial statement and tax purposes. The nature and tax effects of these differences for the years ended December 31 are as follows:

	2014	2013
Deferred compensation not deducted for tax purposes	**$ (41,708)**	$ (76,256)
Loan origination costs	**9,388**	3,651
Loan loss deduction for tax purposes more (less) than provision for financial reporting purposes	**(25,469)**	(474,774)
Depreciation and amortization	**215,526**	56,317
Other, net	**135,263**	418,062
	$ 293,000	$ (73,000)

The components of deferred tax assets and liabilities at December 31 are as follows:

	2014	2013
Assets:		
Allowance for loan losses	**$ 740,557**	$ 750,036
Deferred compensation	**397,973**	399,950
Excess book over tax depreciation, amortization and impairment charges	**-**	11,139
Foreclosed assets basis difference	**-**	1,865
Unrealized loss on cash flow hedge instrument	**139,806**	-
Total deferred tax assets	**1,278,336**	1,162,990
Liabilities:		
Unrealized gain on investment securities available-for-sale	**70,443**	7,333
Loan origination costs	**129,532**	120,143
Unrealized gain on cash flow hedge instrument	**-**	224,814
Excess tax over book depreciation, amortization and impairment charges	**230,364**	-
Prepaid expenses	**105,842**	86,814
Federal Home Loan Bank stock dividends	**33,492**	25,279
Foreclosed assets basis difference	**2,300**	-
Total deferred tax liabilities	**571,973**	464,383
Net deferred tax assets	**$ 706,363**	$ 698,607

15. Financial Instruments with Off-Balance-Sheet Risk:

In order to meet the financing needs of its customers, the Bank commits to extensions of credit and issues standby letters of credit. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Financial instruments with off-balance-sheet risk at December 31 are as follows:

	2014	**2013**
Commitments to extend credit	**$ 49,669,908**	$ 48,385,737
Standby letters of credit and financial guarantees written	**1,086,511**	946,511

16. Loans to Related Parties:

The Bank has granted loans to officers and directors. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties. Activity with respect to these loans during the year ended December 31 was as follows:

	2014	2013
Balance, January 1	**$ 1,211,671**	$ 1,616,071
Net additions or renewals	**435,083**	361,125
Amounts collected or renewed	**(438,478)**	(765,525)
Balance, December 31	**$ 1,208,276**	$ 1,211,671

In addition, there were $859,931 and $957,852 in commitments to extend credit to directors and officers at December 31, 2014 and 2013, respectively, which are included as part of commitments in Note 15.

17. Fair Value Disclosures of Financial Instruments:

The following disclosures are made in accordance with provisions of ASC 825. The use of different assumptions and estimation methods could have a significant effect on fair value amounts. Accordingly, the estimates of fair value herein are not necessarily indicative of the amounts that might be realized in a current market exchange.

The estimated fair values of the financial instruments at December 31 are as follows:

	2014		2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	**$ 40,984,609**	**$40,984,609**	$23,341,636	$ 23,341,636
Cash flow hedge	**-**	**-**	562,036	562,036
Investment securities	**17,358,471**	**17,358,471**	19,313,649	19,313,649
Loans, net of allowance for loan losses	**250,382,990**	**260,326,347**	239,823,302	247,848,141
Interest receivable	**3,069,856**	**3,069,856**	3,009,570	3,009,570
Federal Home Loan Bank stock	**509,800**	**509,800**	530,300	530,300
Financial liabilities:				
Deposits	**291,832,772**	**292,287,820**	264,951,689	265,518,866
Cash flow hedge	**349,515**	349,515	-	-
Trust Preferred Securities	**7,217,000**	**6,147,362**	7,217,000	5,324,258
Convertible Debentures	**-**	**-**	1,473,750	1,473,750
Accrued interest payable	**56,404**	**56,404**	72,003	72,003

Cash and Cash Equivalents – The fair value approximates carrying amount.

Investment securities – Fair value is based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices from similar securities.

Loans – Fair value of fixed-rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Variable rate loans not at contractual floors have carrying amounts that are a reasonable estimate of fair value. Impaired loans' fair values are estimated primarily at collateral values and consider credit risk.

Deposits – Fair value of demand, interest-bearing demand and savings deposits is the amount payable on demand at the reporting date. Fair value of time deposits is estimated using the interest rates currently offered for the deposits of similar remaining maturities. The estimated fair values of deposits do not take into account the benefit that results from low-cost funding such deposits provide.

17. Fair Value Disclosures of Financial Instruments, Continued:

Subordinated debentures – The fair value is estimated by discounting future cash flow at rates currently available for debt with similar terms and maturities.

Off-Balance-Sheet Financial Instruments – The carrying amount and fair value are based on fees charged for similar commitments and are not material.

The following table presents the Company's fair value hierarchy for those assets and liabilities measured at fair value:

	Fair Value Measurements Using				
	Total	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)	Total Period Losses Included in Earnings
December 31, 2014					
Recurring items:					
Cash flow hedge instrument	**$ -**	**$ -**	**$ -**	**$ -**	
Investment securities available for sale	**13,108,009**	**-**	**13,108,009**	**-**	
Total items measured at fair value on a recurring basis	**$13,108,009**	**$ -**	**$13,108,009**	**$ -**	
Non-recurring items:					
Impaired loans net of reserves	**$ 8,789,601**	**$ -**	**$ -**	**$ 8,789,601**	**$1,300,000**
Foreclosed assets	**328,310**	**-**	**-**	**328,310**	**22,825**
Total items measured at fair value on a non-recurring basis	**$ 9,117,911**	**$ -**	**$ -**	**$ 9,117,911**	
December 31, 2013					
Recurring items:					
Cash flow hedge instrument	$ 562,036	$ -	$ 562,036	$ -	
Investment securities available for sale	14,632,026	-	14,632,026	-	
Total items measured at fair value on a recurring basis	$15,194,062	$ -	$15,194,062	$ -	
Non-recurring items:					
Impaired loans net of reserves	$ 946,199	$ -	$ -	$ 946,199	$ 77,389
Foreclosed assets	114,122	-	-	114,122	2,210
Total assets measured at fair value on a non-recurring basis	$ 1,060,321	$ -	$ -	$ 1,060,321	

17. Fair Value Disclosures of Financial Instruments, Continued

The fair value represents management's best estimates based on a range of methodologies and assumptions. For loans with doubt as to collectability and foreclosed assets expected cash flows are discounted using an appropriate rate considering the time of collection, credit risk, and the discount for the uncertainty of the flows. The value of collateral is also considered.

A roll-forward of the assets measured at Fair Value Using Unobservable Inputs (Level III) is as follows:

Fair Value Measurement Using Unobservable Inputs (Level III)

	Impaired loans net of reserves	Foreclosed assets	Total
Beginning balance 12/31/13	$ 946,199	$ 114,122	$ 1,060,321
Net unrealized losses	(1,300,000)	(22,825)	(1,322,825)
Net realized gains (losses)	-	(3,255)	(3,255)
Additions, collections and deletions, net	9,664,845	-	9,664,845
Transfers between Level III at fair value	(521,443)	521,443	-
Sales	-	(281,175)	(281,175)
Ending balance 12/31/14	$ 8,789,601	$ 328,310	$ 9,117,911

18. Regulatory Matters:

Bancorp and the Bank are subject to the regulations of certain federal and state agencies and receive periodic examinations by those regulatory authorities. In addition, Bancorp and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board ("FRB") and Federal Deposit Insurance Corporation ("FDIC"). 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 financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Bancorp's and the Bank's 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 Bancorp and the Bank to maintain minimum amounts and ratios (set forth in the following table below) of Total and Tier I capital to risk-weighted assets, and of Tier I capital to leverage assets, all as defined in the regulations. Management believes, as of December 31, 2014, Bancorp and the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2014, the most recent notification from the FRB and FDIC categorized Bancorp and the Bank as well capitalized. To be categorized as well capitalized the Bank must maintain minimum Total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events from that date through March 13, 2015 that management believes have changed the institution's category.

18. Regulatory Matters, Continued:

Bancorp's and the Bank's actual capital amounts (in thousands) and ratios are also presented in the following table.

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2014:						
Total capital (to risk-weighted assets)						
BEO Bancorp	**$ 35,476**	**13.71%**	**$ 20,706**	**8%**	**N/A**	**N/A**
Bank of Eastern Oregon	**33,560**	**12.97%**	**20,706**	**8%**	**25,820**	**10%**
Tier I capital (to risk-weighted assets)						
BEO Bancorp	**32,241**	**12.46%**	**10,353**	**4%**	**N/A**	**N/A**
Bank of Eastern Oregon	**30,325**	**11.72%**	**10,353**	**4%**	**15,529**	**6%**
Tier I capital (to leverage assets)						
BEO Bancorp	**32,241**	**9.95%**	**12,960**	**4%**	**N/A**	**N/A**
Bank of Eastern Oregon	**30,325**	**9.36%**	**12,960**	**4%**	**16,201**	**5%**
As of December 31, 2013:						
Total capital (to risk-weighted assets)						
BEO Bancorp	$ 32,953	13.43%	$ 19,635	8%	N/A	N/A
Bank of Eastern Oregon	33,017	13.45%	19,635	8%	$ 24,544	10%
Tier I capital (to risk-weighted assets)						
BEO Bancorp	29,885	12.18%	9,817	4%	N/A	N/A
Bank of Eastern Oregon	29,945	12.20%	9,817	4%	14,726	6%
Tier I capital (to leverage assets)						
BEO Bancorp	29,885	10.00%	11,958	4%	N/A	N/A
Bank of Eastern Oregon	29,945	10.02%	11,958	4%	14,948	5%

19. Parent Company Financial Information:

Financial information for BEO Bancorp is presented below:

BALANCE SHEETS

	December 31	
	2014	**2013**
Assets:		
Cash, deposited with the Bank	**$ 1,677,213**	$ 1,194,185
Investments in:		
Bank subsidiary	**30,461,355**	29,869,794
Nonbank subsidiaries (Trusts)	**217,000**	217,000
Unrealized gain on cash flow hedge instrument	**-**	562,036
Other assets, net of amortization	**191,109**	10,000
	$ 32,546,677	$ 31,853,015
Liabilities and stockholders' equity:		
Liabilities:		
Accrued interest payable	**$ 7,079**	$ 7,092
Other Accrued Liabilities	**22,300**	**-**
Unrealized loss on cash flow hedge instrument	**349,515**	-
Deferred Tax Liability	**-**	224,814
Subordinated debt	**7,217,000**	8,690,750
Total liabilities	**7,595,894**	8,922,656
Stockholders' equity:		
Common stock	**3,767,600**	3,253,130
Surplus	**2,625,735**	2,245,027
Retained earnings and accumulated other comprehensive income	**18,713,676**	17,432,202
Treasury stock at cost (6,528 shares)	**(156,228)**	-
Total stockholders' equity	**24,950,783**	22,930,359
Total liabilities and stockholders' equity	**$ 32,546,677**	$ 31,853,015

19. Parent Company Financial Information, Continued:

STATEMENTS OF INCOME

	Year Ended December 31	
	2014	**2013**
Cash dividends from Bank	**$ 712,693**	$ 600,025
Less:		
Interest expense	**(267,187)**	(347,859)
Professional fees and administrative expenses	**(159,719)**	(93,366)
Amortization of capital issuance costs	**(10,000)**	(10,000)
Income (loss) before equity in undistributed earnings of the Bank	**275,787**	148,800
Equity in undistributed earnings of Bank	**1,942,803**	2,284,800
Credit for income taxes	**200,000**	240,000
Net income	**$ 2,418,590**	$ 2,673,600

STATEMENTS OF CASH FLOWS

	Year Ended December 31	
	2014	**2013**
Operating activities:		
Net income	**$ 2,418,590**	$ 2,673,600
Adjustments to reconcile net income to net cash provided by operating activities:		
Undistributed earnings of the Bank	**(1,942,803)**	(2,284,800)
Amortization of capital issuance costs	**10,000**	10,000
Change in other assets and liabilities	**(29,016)**	(61)
Net cash provided by operating activities	**456,771**	398,739
Investing activities:		
Investment in subsidiaries	**1,473,750**	1,620,300
Financing activities:		
Retirement of subordinated debt	**(1,473,750)**	(1,605,000)
Issuance of Common Stock	**895,178**	1,030,125
Repurchase of common stock	**(156,228)**	-
Dividends paid	**(712,693)**	(600,025)
Net cash provided by financing activities	**(1,447,493)**	(1,174,900)
Net increase (decrease) in cash	**483,028**	844,139
Cash, beginning of year	**1,194,185**	350,046
Cash, end of year	**$ 1,677,213**	$ 1,194,185

20. Earnings Per Share:

Earnings per share (EPS) are computed on the basis of the weighted average number of shares outstanding during each year. Diluted EPS includes the effect from the potential issuance of common stock associated with the Subordinated Callable-Convertible Notes (Note 11).

The reconciliation of the numerators and denominators of the basic and diluted EPS calculations is as follows for the fiscal years ended December 31:

	2014	2013
Numerator:		
Net earnings	**$ 2,418,590**	$ 2,673,600
Adjustment for interest expense on convertible notes, net of tax effect	**-**	61,898
Net earnings, adjusted	**$ 2,418,590**	$ 2,735,498
Denominator:		
Basic weighted average shares	**1,158,151**	1,051,703
Dilution for convertible notes	**-**	93,664
Diluted weighted average shares	**1,158,151**	1,145,367
Basic EPS	**$2.09**	$2.54
Diluted EPS	**$2.09**	$2.39

21. Subsequent Event:

On February 28, 2015 Bancorp acquired 100% of the voting stock of Bank Reale of Pasco, Washington which had total assets of $38 million and equity of $2.7 million. All required regulatory and stockholder approval was granted prior to the acquisition date. Consideration for the transaction was in the form of cash and stock. Final terms of the settlement will be determined at a later date as former Bank Reale shareholders elect to exchange their certificates for cash, stock or a combination of cash and stock. Neither Bank Reale nor Bancorp shares are actively traded publically or listed on an exchange, therefore a definite fair market value of the stock portion of the transaction is indeterminable. The acquisition allows the Bank of Eastern Oregon entry into to the eastern Washington market and upon acquisition the Pasco location became a branch of Bank of Eastern Oregon doing business as Bank of Eastern Washington.