NOTE 17 - STOCK COMPENSATION PLAN - *continued*

A summary of the status of the Company's 2003 stock option plan as of December 31, 2007 and 2006, and changes during the period is presented below:

	2007		2006	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	321,992	$ 7.95	400,363	$ 7.75
Granted	-	-	-	
Exercised	(43,145)	5.56	(78,371)	6.94
Forfeited	-	-		
Expired	-		-	
Outstanding at end of year	278,847	8.32	321,992	7.95

The total intrinsic value of options exercised during December 31, 2007 and 2006 was $375,627 and $678,693, respectively.

The following table summarizes information about stock options outstanding under the Company's plan at December 31, 2007:

	Outstanding	Exercisable
Number of options	278,847	278,846
Weighted average remaining life	4.99	4.99
Weighted average exercise price	$ 8.32	$ 8.32

The aggregate intrinsic value of options outstanding at December 31, 2007 was $731,057.

The Company measures the fair value of each option award on the date of grant using the Black-Scholes option pricing model with the following assumptions: the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant; the dividend yield is based on the Company's dividend yield at the time of the grant (subject to adjustment if the dividend yield on the grant date is not expected to approximate the dividend yield over the expected life of the options); the volatility factor is based on the historical volatility of the Company's stock (subject to adjustment if historical volatility is reasonably expected to differ from the past); the weighted-average expected life is based on the historical behavior of employees related to exercises, forfeitures and cancellations. These assumptions are summarized in a table appearing in Note 16 to these financial statements.

No stock options have been granted since June 2005. The Company received $239,746 and $544,138 as a result of stock option exercises during the years ended December 31, 2007 and 2006, respectively. In accordance with SFAS 123(R), the amounts received upon exercise will be included as a financing activity in the accompanying statements of cash flows for the period subsequent to the adoption of SFAS 123(R), and is reported as an operating activity in periods prior to its adoption.

NOTE 18 - 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 material effect on the Company's 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 the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors.

NOTE 18 - REGULATORY MATTERS - *continued*

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum ratios (set forth in the table below) of Tier 1 and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 100%. Tier 1 capital of the Company and the Bank consists of common shareholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

The Company and the Bank are also required to maintain capital at a minimum level based on average assets (as defined), which is known as the leverage ratio. Only the strongest institutions are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

As of the most recent regulatory examination, the Bank was deemed well-capitalized under the regulatory framework for prompt corrective action. To be categorized well capitalized, the Bank must maintain total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events that management believes have changed the Bank's categories.

The following table summarizes the capital amounts and ratios of the Company and the Bank and the regulatory minimum requirements.

(Dollars in thousands)	Actual		Minimum Requirement For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2007						
The Company						
Total capital (to risk-weighted assets)	$ 52,586	10.29%	$ 40,883	8.00%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	47,315	9.26%	20,438	4.00%	N/A	N/A
Tier 1 capital (to average assets)	47,315	9.46%	20,006	4.00%	N/A	N/A
The Bank						
Total capital (to risk-weighted assets)	$ 53,824	10.53%	$ 40,877	8.00%	$ 51,096	10.00%
Tier 1 capital (to risk-weighted assets)	48,554	9.50%	20,438	4.00%	30,658	6.00%
Tier 1 capital (to average assets)	48,554	8.85%	21,945	4.00%	27,445	5.00%
December 31, 2006						
The Company						
Total capital (to risk-weighted assets)	$ 48,458	12.45%	$ 31,149	8.00%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	44,456	11.42%	15,575	4.00%	N/A	N/A
Tier 1 capital (to average assets)	44,456	9.90%	17,968	4.00%	N/A	N/A
The Bank						
Total capital (to risk-weighted assets)	$ 46,444	11.86%	4 31,333	8.00%	$ 39,166	10.00%
Tier 1 capital (to risk-weighted assets)	42,442	10.84%	15,666	4.00%	23,500	6.00%
Tier 1 capital (to average assets)	42,442	9.45%	17,968	4.00%	22,460	5.00%

NOTE 19 - UNUSED LINES OF CREDIT

As of December 31, 2007, the Company had unused lines of credit to purchase federal funds from unrelated companies totaling $37,000,000. These lines of credit are available on a one to fourteen day basis for general corporate purposes. The Company also has a line of credit to borrow funds from the Federal Home Loan Bank of up to $177,511,264. As of December 31, 2007 and 2006, the Company had borrowed $69,000,000 and $28,500,000, respectively, on this line. Additionally, the Company has the ability to buy brokered time deposits at December 31, 2007.

NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount for which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and Due from Banks - The carrying amount is a reasonable estimate of fair value.

Federal Funds Sold and Purchased - Federal funds sold and purchased are for a term of one day and the carrying amount approximates the fair value.

Securities Available-for-Sale - Fair value equals the carrying amount which is the quoted market price. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities.

Nonmarketable Equity Securities - The carrying amount of nonmarketable equity securities is a reasonable estimate of fair value since no ready market exists for these securities.

Loans Held-for-Sale - The carrying amount of loans held for sale is a reasonable estimate of fair value.

Loans Receivable - For certain categories of loans, such as variable rate loans which are repriced frequently and have no significant change in credit risk and credit card receivables, fair values are based on the carrying amounts. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to the borrowers with similar credit ratings and for the same remaining maturities.

Deposits - The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

Securities Sold Under Agreements to Repurchase - The carrying amount is a reasonable estimate of fair value because these instruments typically have terms of one day.

Advances From Federal Home Loan Bank - The fair values of fixed rate borrowings are estimated using a discounted cash flow calculation that applies the Company's current borrowing rate from the Federal Home Loan Bank. The carrying amounts of variable rate borrowings are reasonable estimates of fair value because they can be repriced frequently.

Junior Subordinated Debentures - The carrying value of junior subordinated debentures approximates its fair value since the debentures were issued at a floating rate.

Accrued Interest Receivable and Payable - The carrying value of these instruments is a reasonable estimate of fair value.

Off-Balance-Sheet Financial Instruments - Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

NOTE 20 - FAIR VALUE OF FINANCIAL INSTRUMENTS - *continued*

The carrying values and estimated fair values of the Company's financial instruments were as follows:

	December 31,			
	2007		2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and due from banks	$ 7,164,650	$ 7,164,650	$ 17,328,075	$ 17,328,075
Federal funds sold	-	-	14,135,000	14,135,000
Securities available-for-sale	58,580,313	58,580,313	35,931,271	35,931,271
Nonmarketable equity securities	3,930,400	3,930,400	2,187,600	2,187,600
Loans, including loans held for sale	487,738,540	481,470,000	360,123,046	350,547,000
Accrued interest receivable	3,092,767	3,092,767	2,464,531	2,464,531
Financial Liabilities:				
Demand deposit, interest-bearing transaction, and savings accounts	$ 168,812,402	$ 168,812,402	$ 154,182,263	$ 154,182,263
Certificates of deposit	280,685,313	280,593,000	218,755,820	219,450,000
Securities sold under agreements to repurchase	7,927,754	7,927,754	8,120,014	8,120,014
Advances from Federal Home Loan Bank	69,000,000	69,000,000	28,500,000	28,465,000
Federal Funds Purchased	13,359,000	13,359,000	-	-
Note payable	3,000,000	3,000,000	-	-
Junior subordinated debentures	10,310,000	10,310,000	10,310,000	10,310,000
Accrued interest payable	767,577	767,577	766,276	766,276
	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Off-Balance-Sheet Financial Instruments:				
Commitments to extend credit	$ 76,545,909	$ -	$ 67,370,404	$ -
Standby letters of credit	2,721,249	-	3,543,270	-

NOTE 21 - SUBSEQUENT EVENTS

On November 10, 2007, the Bank entered into a contract to purchase approximately 1.37 acres of land located in North Charleston, South Carolina. The purchase price for the property was $1,400,000. The contract included an inspection period of ninety days from the effective date in which the Banj had the right to terminate the contract. The purchase of this property closed on March 10, 2008.

NOTE 22 - FIRST RELIANCE BANCSHARES, INC. (PARENT COMPANY ONLY)

Condensed Balance Sheets

	December 31, 2007	December 31, 2006
Assets		
Cash	$ 665,117	$ 923,308
Investment in banking subsidiary	48,530,277	42,389,421
Marketable Investments	251,650	311,505
Nonmarketable equity securities	-	100,000
Investment in trust	310,000	310,000
Other assets	773,761	499,301
Total assets	$ 50,530,805	$ 44,533,535
Liabilities		
Accounts payable	$ 192,901	$ 130,272
Note payable	3,000,000	-
Junior subordinated debentures	10,310,000	10,310,000
Total liabilities	13,502,901	10,440,272
Shareholders' equity	37,027,904	34,093,263
Total liabilities and shareholders' equity	$ 50,530,805	$ 44,533,535

Condensed Statements of Income

	December 31, 2007	December 31, 2006
Income	$ 21,533	$ 24,623
Expenses	850,585	755,001
Loss before income taxes and equity in undistributed earnings of banking subsidiary	(829,052)	(730,378)
Income tax benefit	276,275	315,501
Income before equity in undistributed earning of banking subsidiary	(552,777)	(414,877)
Equity in undistributed earnings of banking subsidiary	3,112,297	3,660,785
Net income	$ 2,559,520	$ 3,245,908

NOTE 22 - FIRST RELIANCE BANCSHARES, INC. (PARENT COMPANY ONLY) - *continued*

Condensed Statements of Cash Flows

	December 31, 2007	December 31, 2006
Cash flows from operating activities		
Net income	$ 2,559,520	$ 3,245,908
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in other assets	(276,960)	(441,960)
Increase in other liabilities	82,980	65,476
Equity in undistributed earnings of banking subsidiary	(3,112,297)	(3,660,785)
Net cash used by operating activities	(746,757)	(791,361)
Cash flows from investing activities		
Purchase of nonmarketable equity securities		(100,000)
Investment in banking subsidiary	(3,000,000)	
Proceeds on sale of non marketable securities	102,500	-
Net cash used by investing activities	(2,897,500)	(100,000)
Cash flows from financing activities		
Proceeds from exercise of stock options	239,746	544,138
Issuance of shares to ESOP	198,380	472,747
Sale of treasury stock	(145,198)	9,896
Issuance of restricted stock	76,379	33,632
Issuance of shares to Advisory Board	16,759	15,025
Proceeds from note payable	3,000,000	-
Net cash provided (used) by financing activities	3,386,066	1,075,438
(Decrease) increase in cash	(258,191)	184,077
Cash and cash equivalents, beginning of year	923,308	739,231
Cash and cash equivalents, ending of year	$ 665,117	$ 923,308

NOTE 23 - QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The tables below represent the quarterly results of operations for the years ended December 31, 2007 and 2006, respectively:

	December 31, 2007			
	Fourth	Third	Second	First
Total interest and fee income	$ 10,097,678	$ 9,708,594	$ 9,318,103	$ 8,416,112
Total interest expense	4,740,765	5,011,381	4,653,632	4,027,431
Net interest income	5,356,913	4,697,213	4,664,471	4,388,681
Provision for loan losses	773,702	408,962	325,202	135,234
Net interest income after provisions for loan losses	4,583,211	4,288,251	4,339,269	4,253,447
Other income	1,420,328	1,264,500	1,423,726	1,193,185
Other expense	5,344,626	4,624,605	4,486,802	4,505,242
Income before income tax expense	658,913	928,208	1,276,193	941,390
Income tax expense	299,182	343,331	368,486	234,183
Net income	$ 359,731	$ 584,877	$ 907,708	$ 707,207
Basic income per common share	$ .10	$ .17	$ .26	$ .21
Diluted income per common share	$ .10	$ .17	$ .26	$ .20

	December 31, 2006			
	Fourth	Third	Second	First
Total interest and fee income	$ 8,571,562	$ 8,484,778	$ 7,635,918	$ 7,024,327
Total interest expense	4,001,265	3,938,100	3,258,676	3,015,658
Net interest income	4,570,297	4,546,678	4,377,242	4,008,669
Provision for loan losses	224,500	477,205	440,501	250,285
Net interest income after provisions for loan losses	4,345,797	4,069,473	3,936,741	3,758,384
Other income	1,166,574	1,232,896	1,252,768	938,455
Other expense	4,340,612	4,024,389	4,022,098	3,885,285
Income before income tax expense	1,171,759	1,277,980	1,167,411	811,554
Income tax expense	187,382	413,068	344,495	237,851
Net income	$ 984,377	$ 864,912	$ 822,916	$ 573,703
Basic income per common share	$ .30	$ .25	$ .24	$ .17
Diluted income per common share	$ .27	$ .25	$ .23	$ .16

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 5 - Earnings Per Share - *continued*

	Three Months Ended September 30, 2007		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share			
Income available to common shareholders	$ 584,877	3,485,861	$ 0.17
Effect of dilutive securities			
Stock options	-	31,648	
Non – vested restricted stock	-	7,665	
Diluted earnings per share			
Income available to common shareholders plus assumed conversions	$ 584,877	3,525,174	$ 0.17

Note 6 - Comprehensive Income

The components of other comprehensive income and related tax effects are as follows:

	Pre-tax Amount	Tax Benefit (Expense)	Net-of-tax Amount
For the Nine Months Ended September 30, 2008:			
Unrealized losses on securities available-for-sale	$ (1,937,592)	$ 658,781	$ (1,278,811)
Reclassification adjustment for gains (losses) realized in net income	-	-	-
	$ (1,937,592)	$ 658,781	$ (1,278,811)
For the Nine Months Ended September 30, 2007:			
Unrealized losses on securities available-for-sale	$ (327,355)	$ 111,301	$ (216,054)
Reclassification adjustment for gains (losses) realized in net income	3,496	(1,189)	2,307
	$ (323,859)	$ 110,112	$ (213,747)
For the Three Months Ended September 30, 2008:			
Unrealized losses on securities available-for-sale	$ (780,997)	$ 265,539	$ (515,458)
Reclassification adjustment for gains (losses) realized in net income	-	-	-
	$ (780,997)	$ 265,539	$ (515,458)
For the Three Months Ended September 30, 2007:			
Unrealized gains on securities available-for-sale	$ 333,162	$ (113,275)	$ 219,887
Reclassification adjustment for gains (losses) realized in net income	-	-	-
	$ 333,162	$ (113,275)	$ 219,887

Accumulated other comprehensive income consists solely of net unrealized gains and losses on securities available for sale, net of the deferred tax effects.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Balance Sheets

	June 30, 2008 (Unaudited)	December 31, 2007 (Audited)
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 6,777,796	$ 7,164,650
Federal funds sold	6,015,000	-
Total cash and cash equivalents	12,792,796	7,164,650
Securities available-for-sale	55,125,216	58,580,313
Nonmarketable equity securities	4,372,200	3,930,400
Total investment securities	59,497,416	62,510,713
Loans held for sale	10,447,997	19,600,850
Loans receivable	466,428,206	468,137,690
Less allowance for loan losses	(5,740,860)	(5,270,607)
Loans, net	460,687,346	462,867,083
Premises, furniture and equipment, net	23,678,331	22,233,746
Accrued interest receivable	2,712,271	3,092,767
Other real estate owned	473,550	196,950
Cash surrender value life insurance	10,769,838	10,540,273
Other assets	4,092,857	3,497,180
Total assets	$ 585,152,402	$ 591,704,212
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing transaction accounts	$ 47,008,751	$ 43,542,528
Interest-bearing transaction accounts	28,321,944	39,450,393
Savings	82,073,717	85,819,481
Time deposits $100,000 and over	179,899,406	169,825,252
Other time deposits	118,971,469	110,860,061
Total deposits	456,275,287	449,497,715
Securities sold under agreement to repurchase	6,421,356	7,927,754
Federal funds purchased	-	13,359,000
Advances from Federal Home Loan Bank	68,500,000	69,000,000
Note payable	3,000,000	3,000,000
Junior subordinated debentures	10,310,000	10,310,000
Accrued interest payable	596,016	767,577
Other liabilities	2,396,273	814,262
Total liabilities	547,498,932	554,676,308
Shareholders' Equity		
Common stock, $0.01 par value; 20,000,000 shares authorized, Issued 3,523,775 shares at June 30, 2008 and 3,504,313 shares at December 31, 2007 Shares Outstanding 3,513,524 at June 30, 2008 and 3,494,646 at December 31, 2007	35,135	34,946
Nonvested restricted stock	(237,078)	(152,762)
Capital surplus	26,050,718	25,875,012
Treasury stock (10,251 and 9,667 shares at cost in 2008 and 2007, respectively)	(153,500)	(145,198)
Retained earnings	12,722,917	11,417,275
Accumulated other comprehensive loss	(764,722)	(1,369)
Total shareholders' equity	37,653,470	37,027,904
Total liabilities and shareholders' equity	$ 585,152,402	$ 591,704,212

See notes to condesed financial statements

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Income
(Unaudited)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2008	2007	2008	2007
Interest income:				
Loans, including fees	$ 17,660,316	$ 16,510,892	$ 8,560,841	$ 8,618,219
Investment securities:				
Taxable	675,964	446,076	329,580	211,742
Nontaxable	655,492	352,957	327,882	182,816
Federal funds sold	11,840	336,410	9,947	257,751
Other interest income	113,964	87,880	62,674	47,575
Total	19,117,576	17,734,215	9,290,924	9,318,103
Interest expense:				
Time Deposits over $100,000	4,032,916	3,152,637	1,995,863	1,760,167
Other deposits	3,405,068	4,604,489	1,502,973	2,416,821
Other interest expense	1,884,358	923,937	964,838	476,644
Total	9,322,342	8,681,063	4,463,674	4,653,632
Net interest income	9,795,234	9,053,152	4,827,250	4,664,471
Provision for loan losses	1,147,397	460,436	645,794	325,202
Net interest income after provision for loan losses	8,647,837	8,592,716	4,181,456	4,339,269
Noninterest income:				
Service charges on deposit accounts	929,852	908,437	492,717	465,767
Gain on sales of mortgage loans	1,126,357	1,116,131	566,973	645,889
Brokerage fees	106,557	85,869	56,227	45,009
Income from Bank Owned Life Insurance	229,565	201,050	107,811	100,310
Other charges, commissions and fees	238,095	167,394	124,823	89,632
Gain on sale of securities	-	5,996	-	4,975
Gain on sale of other real estate	-	20,374	-	11,009
Gain on sale of fixed assets	-	16,104	-	1,689
Other non-interest income	100,869	95,556	50,950	59,446
Total	2,731,295	2,616,911	1,399,501	1,423,726
Noninterest expenses:				
Salaries and employee benefits	5,753,376	5,227,430	2,808,625	2,631,655
Occupancy expense	731,432	655,892	391,729	318,496
Furniture and equipment expense	422,490	419,763	209,531	229,102
Other operating expenses	2,554,775	2,688,958	1,317,792	1,307,548
Total	9,462,073	8,992,043	4,727,677	4,486,801
Income before income taxes	1,917,059	2,217,584	853,280	1,276,194
Income tax expense	407,515	602,669	169,859	368,486
Net income	$ 1,509,544	$ 1,614,915	$ 683,421	$ 907,708
Earnings per share				
Basic earnings per share	$ 0.43	$ 0.47	$ 0.20	$ 0.26
Diluted earnings per share	$ 0.43	$ 0.45	$ 0.20	$ 0.26

See notes to condesed financial statements

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income
For the six months ended June 30, 2008 and 2007
(Unaudited)

	Common Stock			Restricted	Treasury	Retained	Accumulated Other Compre-hensive Income	
	Shares	Amount	Surplus	Stock	Stock	Earnings	(Loss)	Total
Balance, December 31, 2006	3,424,878	$ 34,249	$ 25,257,814	$ (66,131)	$ -	$ 8,857,755	$ 9,576	$ 34,093,263
Net income						1,614,915		1,614,915
Other comprehensive loss, net of tax benefit of $222,198							(433,634)	(433,634)
Comprehensive income								1,181,281
Issuance of shares to 404c plan	13,383	134	198,246					198,380
Restricted stock	7,118	71	106,663	(76,397)				30,337
Exercise of stock options	39,145	391	213,430					213,821
Balance, June 30, 2007	3,484,524	$ 34,845	$ 25,776,153	$ (142,528)	$ -	$ 10,472,670	$ (424,058)	$ 35,717,082
Balance, December 31, 2007	3,494,646	$ 34,946	$ 25,875,012	$ (152,762)	$ (145,198)	$ 11,417,275	$ (1,369)	$ 37,027,904
Adjustment to reflect the cumulative-effect of change in Accounting for Life Insurance Arrangement						(203,902)		(203,902)
Balance December 31, 2007	3,494,646	34,946	25,875,012	(152,762)	(145,198)	11,213,373	(1,369)	36,824,002
Net income						1,509,544		1,509,544
Other comprehensive loss Net of tax benefit of $393.242							(763,353)	(763,353)
Comprehensive Income								746,191
Purchase of Treasury Stock					(8,302)			(8,302)
Restricted stock	14,028	140	150,739	(84,316)				66,563
Exercise of Stock Options	4,850	49	24,967					25,016
Balance, June 30, 2008	3,513,524	$ 35,135	$ 26,050,718	$ (237,078)	$ (153,500)	$ 12,722,917	$ (764,722)	$ 37,653,470

See notes to condesed financial statements

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash flows from operating activities:		
Net income	$ 1,509,544	$ 1,614,915
Adjustments to reconcile net income to net cash		
Provided by operating activities:		
Provision for loan losses	1,147,397	460,436
Depreciation and amortization expense	472,929	359,363
Gain on sale of equipment	-	(16,104)
Gain on sale of other real estate owned	-	(20,374)
Gain on sale of available-for-sale securities	-	(5,996)
Write down of other real estate owned	106,750	-
Discount accretion and premium amortization	15,581	31,135
Disbursements for loans held-for-sale	(74,296,578)	(69,616,601)
Proceeds from loans held-for-sale	83,449,431	69,775,703
Deferred income tax benefit	(582,426)	(1,005,942)
Decrease in interest receivable	380,496	42,850
Increase (decrease) in interest payable	(171,561)	14,131
Amortization of deferred compensation on restricted stock	66,563	30,337
Increase (decrease) in other liabilities	1,405,049	(661,247)
(Increase) decrease in other assets	3,078	165,044
Net cash provided by operating activities	13,506,253	1,167,650
Cash flows from investing activities:		
Net (increase) decrease in loans receivable	623,490	(51,218,168)
Purchases of securities available-for-sale	-	(10,019,236)
Proceeds on sales of securities available-for-sale	-	9,785,569
Maturities of securities available-for-sale	2,282,921	1,067,689
Purchase of non marketable equity securities	(441,800)	(857,300)
Proceeds on sale of nonmarketable equity securities	-	1,052,000
Sales of other real estate owned	25,500	869,222
Proceeds from disposal of premises, furniture, and equipment	-	38,066
Purchases of premises and equipment	(1,797,105)	(4,489,472)
Net cash provided (used) by investing activities	693,006	(53,771,630)
Cash flows from financing activities:		
Net increase (decrease) in demand deposits, interest bearing and savings accounts	(11,407,990)	6,892,789
Net increase in certificates of deposit and other time deposits	18,185,561	44,922,760
Decrease in Federal Funds purchased	(13,359,000)	-
Net (decrease) increase in securities sold under agreements to repurchase	(1,506,398)	3,010,825
Decrease in advances from the Federal Home Loan Bank	(500,000)	(2,500,000)
Proceeds from issuance of shares to ESOP	-	198,380
Sale of treasury stock	(8,302)	-
Proceeds from the exercise of stock options	25,016	213,821
Net cash provided (used) by financing activities	(8,571,113)	52,738,575
Net increase in cash and cash equivalents	5,628,146	134,595
Cash and cash equivalents, beginning of period	7,164,650	31,463,075
Cash and cash equivalents, end of period	$ 12,792,796	$ 31,597,670
Cash paid during the period for		
Income taxes	$ 922,499	$ 378,034
Interest	$ 9,493,903	$ 8,695,194

See notes to condensed financial statements.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying financial statements have been prepared in accordance with the requirements for interim financial statements and, accordingly, they are condensed and omit disclosures, which would substantially duplicate those contained in the most recent annual report to shareholders. The financial statements as of June 30, 2008 and 2007 and for the interim periods then ended are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation. The financial information as of December 31, 2007 has been derived from the audited financial statements as of that date. For further information, refer to the financial statements and the notes included in First Reliance Bancshares, Inc.'s 2007 Annual Report on Form 10-K.

Note 2 - Recently Issued Accounting Pronouncements

The following is a summary of recent authoritative pronouncements:

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," ("SFAS 141(R)") which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. Accordingly, a calendar year-end company is required to record and disclose business combinations following existing accounting guidance until January 1, 2009. The Company will assess the impact of SFAS 141(R) if and when a future acquisition occurs.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting noncontrolling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financials statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The Company is currently evaluating the impact, if any, the adoption of SFAS 160 will have on its financial position, results of operations and cash flows.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improving the transparency of financial reporting. It is intended to enhance the current disclosure framework in SFAS 133 by requiring that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. This disclosure better conveys the purpose of derivative use in terms of the risks that the entity is intending to manage. SFAS 161 is effective for the Company on January 1, 2009. This pronouncement does not impact accounting measurements but will result in additional disclosures if the Company is involved in material derivative and hedging activities at that time.

In February 2008, the FASB issued FASB Staff Position No. 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions" ("FSP 140-3"). This FSP provides guidance on accounting for a transfer of a financial asset and the transferor's repurchase financing of the asset. This FSP presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS No. 140. However, if certain criteria are met, the initial transfer and repurchase financing are not evaluated as a linked transaction and are evaluated separately under Statement 140. FSP 140-3 will be effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years and earlier application is not permitted. Accordingly, this FSP is effective for the Company on January 1, 2009. The Company is currently evaluating the impact, if any, the adoption of FSP 140-3 will have on its financial position, results of operations and cash flows.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 2 - Recently Issued Accounting Pronouncements- *continued*

In April 2008, the FASB issued FASB Staff Position No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets". The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," and other U.S. generally accepted accounting principles. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and early adoption is prohibited. Accordingly, this FSP is effective for the Company on January 1, 2009. The Company does not believe the adoption of FSP 142-3 will have a material impact on its financial position, results of operations or cash flows.

Effective January 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS 157") which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. SFAS 157 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1	Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasuries and money market funds.
Level 2	Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, mortgage-backed securities, municipal bonds, corporate debt securities, and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.
Level 3	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly-structured or long-term derivative contracts.

		Quoted Market Price in active Markets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)
Available for Sale Securities	$	-	$	55,125,216		-
Mortgage Loans Held for Sale	$	-	$	10,447,997		-
Total	$	-	$	65,573,213		-

The Company has no liabilities carried at fair value or measured at fair value on a nonrecurring basis.

The Company is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be level 2 inputs. The aggregate carrying amount of impaired loans at June 30, 2008 was $3,308,463.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 2 - Recently Issued Accounting Pronouncements- *continued*

FASB Staff Position No. FAS 157-2 delays the implementation of SFAS 157 until the first quarter of 2009 with respect to goodwill, other intangible assets, real estate and other assets acquired through foreclosure and other non-financial assets measured at fair value on a nonrecurring basis.

The Company has no assets or liabilities whose fair values are measured using level 3 inputs.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Note 3 - Equity Incentive Plan

During the first quarter of 2006, the Company adopted the 2006 Equity Incentive Plan. The 2006 Equity Incentive Plan provides for the granting of dividend equivalent rights, options, performance unit awards, phantom shares, stock appreciation rights, and stock awards of up to 350,000 shares of the Company's common stock to officers, employees, directors, consultants, and other service providers of the Company, or any Affiliate of the Company.

During the six months ended June 30, 2008 and 2007, the Company granted 0 and 62,481 stock appreciation rights, respectively. A stock appreciation right entitles an individual to receive the excess of the fair market value from the grant date to the exercise date in a settlement of Company stock. The Company has funded the liability through charges to earnings. The accrued liability for the stock appreciation rights at June 30, 2008 was $139,012.

During the three months ended June 30, 2008 and 2007, the company did not issue any stock appreciation rights.

A summary of the status of the Company's stock appreciation rights as of the six and three months ended June 30, 2008 and 2007 is presented below:

For the Six Months Ended June 30,	2008		2007	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at January 1	93,981	$ 14.95	45,504	$ 14.87
Granted	-	-	62,481	15.00
Exercised	-	-	-	-
Forfeited	-	-	-	-
Outstanding at June 30	93,981	$ 14.95	107,985	$ 14.95

For the Three Months Ended June 30,	2008		2007	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at April 1	93,981	14.95	107,985	$ 14.95
Granted	-	-	-	-
Exercised	-	-	-	-
Forfeited	-	-	-	-
Outstanding at June 30	93,981	$ 14.95	107,985	$ 14.95

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 3 - Equity Incentive Plan - *continued*

During the six and three months ended June 30, 2008, the Company granted 14,059 and 50 shares of restricted stock, respectively, pursuant to the 2006 Equity Incentive Plan. The shares "cliff" vests in three years. Compensation cost associated with the grant was $67,068 and $37,053 for the six and three months ended June 30, 2008, respectively.

The following table shows the changes in the Company's restricted stock for the six and three months ended June 30, 2008:

	Six months	Three months
Outstanding at January 1, and April 1, respectively	16,195	28,385
Granted	14,059	50
Exercised	(1,819)	
Forfeited		
Outstanding at June 30, 2008	28,435	28.435

Note 4 - Stock Compensation Plan

On June 19, 2003, the Company established the 2003 First Reliance Bank Employee Stock Option Plan (Stock Plan) that provides for the granting of options to purchase up to 250,000 shares of the Company's common stock to directors, officers, or employees of the Company. This plan was preceded by the 1999 First Reliance Bank Employee Stock Option Plan, which provided for the granting of options to purchase up to 238,000 shares of the Company's common stock to directors, officers, or employees of the Company. The per-share exercise price of incentive stock options granted under the Stock Plan may not be less than the fair market value of a share on the date of grant. The per-share exercise price of stock options granted is determined by the Board of Directors. The expiration date of any option may not be greater than ten years from the date of grant. Options that expire unexercised or are canceled become available for reissuance. At June 30, 2008, there were no options available for grant under the 2003 plan and no options available for grant under the 1999 plan.

The following shows the status of the Company's stock option plan at June 30, 2008 and the changes in the plan for the six and three months ended June 30, 2008:

	Six months ended		Three months ended	
	Shares	Weighted Average Price	Shares	Weighted Average Price
Outstanding at January 1, and April 1, respectively	278,847	$ 8.32	271,847	$ 8.35
Granted				
Exercised	(4,700)	5.00	(200)	5.00
Forfeited	(2,500)	11.00		
Outstanding at June 30, 2008	271,647	$ 8.35	271,647	$ 8.35

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 5 - Earnings Per Share

The following schedule reconciles the numerators and denominators of the basic and diluted earnings per share computations for the six and three month periods ended June 30, 2008 and 2007. Dilutive common shares arise from the potentially dilutive effect of the company's stock options and warrants that are outstanding. The assumed conversion of stock options and warrants can create a difference between basic and dilutive net income per common share.

	Six Months Ended June 30, 2008		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share			
Income available to common shareholders	$ 1,509,544	3,504,070	$ 0.43
Effect of dilutive securities			
Stock options	-	25,198	
Non vested restricted stock	-	3,404	
Diluted earnings per share			
Income available to common shareholders plus assumed conversions	$ 1,509,544	3,532,672	$ 0.43

	Six Months Ended June 30, 2007		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share			
Income available to common shareholders	$ 1,614,915	3,445,007	$ 0.47
Effect of dilutive securities			
Stock options	-	104,857	
Non vested restricted stock	-	39	
Diluted earnings per share			
Income available to common shareholders Plus assumed conversions	$ 1,614,915	3,549,903	$ 0.45

	Three Months Ended June 30, 2008		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share			
Income available to common shareholders	$ 683,421	3,513,278	$ 0.20
Effect of dilutive securities			
Stock options	-	28,435	
Non - vested restricted stock	-	8,842	
Diluted earnings per share			
Income available to common shareholders plus assumed conversions	$ 683,421	3,550,555	$ 0.20

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 5 - Earnings Per Share - *continued*

	Three Months Ended June 30, 2007		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share			
Income available to common shareholders	$ 907,708	3,457,850	$ 0.26
Effect of dilutive securities			
Stock options	-	78,010	
Non - vested restricted stock	-	1	
Diluted earnings per share			
Income available to common shareholders plus assumed conversions	$ 907,708	3,535,861	$ 0.26

Note 6 - Comprehensive Income

The components of other comprehensive income and related tax effects are as follows:

	Pre-tax Amount	Tax Benefit	Net-of-tax Amount
For the Six Months Ended June 30, 2008:			
Unrealized losses on securities available-for-sale	$ (1,156,595)	$ 393,242	$ (763,353)
Reclassification adjustment for gains (losses) realized in net income			
	$ (1,156,595)	$ 393,242	$ (763,353)
For the Six Months Ended June 30, 2007:			
Unrealized losses on securities available-for-sale	$ (659,328)	$ 223,387	$ (435,941)
Reclassification adjustment for gains (losses) realized in net income	3,496	(1,189)	2,307
	$ (655,832)	$ 222,198	$ (433,634)
For the Three Months Ended June 30, 2008:			
Unrealized losses on securities available-for-sale	$ (1,301,521)	$ 442,517	$ (859,004)
Reclassification adjustment for gains (losses) realized in net income			
	$ (1,301,521)	$ 442,517	$ (859,004)
For the Three Months Ended June 30, 2007:			
Unrealized losses on securities available-for-sale	$ (710,552)	$ 241,232	$ (469,320)
Reclassification adjustment for gains (losses) realized in net income	2,475	(842)	1,633
	$ (708,077)	$ 240,390	$ (467,687)

Accumulated other comprehensive income consists solely of net unrealized gains and losses on securities available for sale, net of the deferred tax effects.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
First Reliance Bancshares, Inc. and Subsidiary
Florence, South Carolina

We have audited the accompanying consolidated balance sheets of First Reliance Bancshares, Inc. and subsidiary as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in shareholders' equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of First Reliance Bancshares, Inc. and subsidiary as of December 31, 2005 and 2004, and the consolidated results of their operations and cash flows for each of the years then ended in conformity with accounting principles generally accepted in the United States of America.

Elliott Davis, LLC
Columbia, South Carolina
February 9, 2006

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Consolidated Balance Sheets

	December 31, 2005	December 31, 2004
Assets:		
Cash and cash equivalents:		
Cash and due from banks	$ 7,264,897	$ 3,803,535
Federal funds sold	22,442,000	1,042,000
Total cash and cash equivalents	29,706,897	4,845,535
Investment securities:		
Securities available-for-sale	37,121,479	28,567,666
Nonmarketable equity securities	1,745,850	1,714,700
Investment in trust	310,000	—
Total investment securities	39,177,329	30,282,366
Loans held for sale	7,994,603	1,332,890
Loans receivable	311,544,385	238,362,092
Less allowance for loan losses	(3,419,368)	(2,758,225)
Loans, net	308,125,017	235,603,867
Premises, furniture and equipment, net	10,020,537	5,891,402
Accrued interest receivable	2,189,742	1,458,673
Other real estate owned	345,550	320,598
Cash surrender value life insurance	3,752,165	3,415,582
Other assets	1,726,044	1,819,970
Total assets	$ 403,037,884	$ 284,970,883
Liabilities:		
Deposits:		
Noninterest-bearing transaction accounts	$ 39,222,574	$ 27,560,581
Interest-bearing transaction accounts	29,437,107	15,525,590
Savings	79,663,175	46,299,198
Time deposits $100,000 and over	113,268,921	93,975,912
Other time deposits	72,845,121	42,132,546
Total deposits	334,436,898	225,493,827
Securities sold under agreements to repurchase	3,859,904	3,061,903
Advances from Federal Home Loan Bank	23,500,000	27,900,000
Junior subordinated debentures	10,310,000	—
Accrued interest payable	446,303	742,017
Other liabilities	834,144	414,487
Total liabilities	373,387,249	257,612,234
Commitments and contingencies (Notes 4, 5 and 14)		
Shareholders' Equity:		
Common stock, $0.01 par value, 5,000,000 shares authorized; 3,306,117 and 3,203,942 shares issued and outstanding at December 31, 2005 and 2004, respectively	33,061	32,039
Capital surplus	24,127,329	23,428,034
Treasury stock (800 shares in 2005 and 600 shares in 2004)	(9,896)	(7,396)
Retained earnings	5,611,847	3,664,301
Accumulated other comprehensive income (loss)	(111,706)	241,671
Total shareholders' equity	29,650,635	27,358,649
Total liabilities and shareholders' equity	$ 403,037,884	$ 284,970,883

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

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Consolidated Statements of Income

	For the years ended December 31, 2005	2004
Interest income:		
Loans, including fees	$ 21,236,608	$ 12,094,388
Investment securities:		
Taxable	770,863	723,439
Tax exempt	553,993	415,347
Federal funds sold	478,597	16,942
Other interest income	91,051	40,365
Total	23,131,112	13,290,481
Interest expense:		
Time deposits $100,000 and over	3,485,397	1,870,930
Other deposits	4,097,836	1,627,009
Other interest expense	1,395,446	563,129
Total	8,978,679	4,061,068
Net interest income	14,152,433	9,229,413
Provision for loan losses	1,811,317	1,361,762
Net interest income after provision for loan losses	12,341,116	7,867,651
Noninterest income:		
Service charges on deposit accounts	1,357,214	1,231,759
Gain on sale of mortgage loans	877,843	584,023
Brokerage fees	160,569	131,626
Credit life insurance commissions	32,606	82,090
Other service charges, commissions, and fees	206,783	145,403
Gain on sale of securities available-for-sale	—	5,971
Loss on sale of other real estate	(66,815)	(55,966)
Loss on sale of fixed assets	(287)	(20,000)
Other	303,374	274,617
Total	2,871,287	2,379,523
Noninterest expenses:		
Salaries and benefits	7,136,376	4,874,035
Occupancy	919,584	425,686
Furniture and equipment related expenses	712,308	616,186
Other operating	3,707,173	2,422,035
Total	12,475,441	8,337,942
Income before income taxes	2,736,962	1,909,232
Income tax expense	789,416	570,533
Net income	1,947,546	$ 1,338,699
Earnings per share:		
Basic	$ 0.60	$ 0.52
Diluted	$ 0.57	$ 0.48

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

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income
For the years ended December 31, 2005 and 2004

	Common Stock						
	Shares	Amount	Capital Surplus	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2003	2,466,660	$ 24,667	$ 15,106,070	$ —	$ 2,325,602	$ 246,300	$ 17,702,639
Net income					1,338,699		1,338,699
Other comprehensive loss, net of tax benefit of $2,384						(4,629)	(4,629)
Comprehensive income							1,334,070
Proceeds from stock issuance	700,000	7,000	8,043,000				8,050,000
Costs associated with stock offering			(75,960)				(75,960)
Issuance of shares to ESOP	37,282	372	354,924				355,296
Purchase of treasury stock				(7,396)			(7,396)
Balance, December 31, 2004	3,203,942	32,039	23,428,034	(7,396)	3,664,301	241,671	27,358,649
Net income					1,947,546		1,947,546
Other comprehensive loss, net of tax benefit of $182,043						(353,377)	(353,377)
Comprehensive income							1,594,169
Purchase of treasury stock				(2,500)			(2,500)
Issuance of shares to ESOP	23,175	232	298,725				298,957
Exercise of stock options	79,000	790	400,570				401,360
Balance, December 31, 2005	3,306,117	$ 33,061	$ 24,127,329	$ (9,896)	$ 5,611,847	$ (111,706)	$ 29,650,635

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

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

	For the years ended December 31, 2005	2004
Cash flows from operating activities:		
Net income	$ 1,947,546	$ 1,338,699
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Provision for loan losses	1,811,317	1,361,762
Depreciation and amortization expense	658,255	548,822
Gain on sales of securities available-for-sales	—	(5,971)
Discount accretion and premium amortization	86,839	108,066
Disbursements for mortgages held for sale	(74,459,914)	(25,160,598)
Proceeds from sales of mortgages held for sale	67,798,201	24,799,335
Writedown of other real estate owned	45,750	58,000
(Gain) loss on sale of other real estate owned	(8,735)	18,815
Deferred income tax provision (benefit)	(136,148)	(50,801)
Increase in interest receivable	(774,975)	(509,010)
Decrease in interest payable	(251,808)	299,784
(Increase) decrease in other assets	75,534	(3,989,862)
Increase (decrease) in other liabilities	419,657	116,997
Net cash provided (used) by operating activities	(2,788,481)	(1,065,962)
Cash flows from investing activities:		
Purchases of securities available-for-sale	(13,757,943)	(11,232,623)
Maturities of securities available-for-sale	4,581,871	4,268,455
Proceeds from sales of nonmarketable equity securities	1,629,000	5,976,385
Purchases of nonmarketable equity securities	(1,660,150)	(839,700)
Purchase of junior subordinated debentures	(310,000)	—
Proceeds from the sales of nonmarketable equity securities	—	180,000
Net increase in loans receivable	(74,687,811)	(99,855,322)
Purchases of premises, furniture and equipment	(4,815,411)	(643,405)
Proceeds from disposal of premises, furniture and equipment	28,021	—
Proceeds from sale of other real estate owned	293,377	408,455
Net cash used by investing activities	(88,699,046)	(101,737,755)
Cash flows from financing activities:		
Net increase in demand deposits, interest-bearing transaction accounts and savings accounts	58,937,487	36,217,217
Net increase in certificates of deposit and other time deposits	50,005,584	49,861,660
Increase (decrease) in advances from Federal Home Loan Bank	(4,400,000)	8,800,000
Increase (decrease) in federal funds purchased	—	(1,043,000)
Net increase (decrease) in securities sold under agreements to repurchase	798,001	698,333
Proceeds from junior subordinated debentures	10,310,000	—
Stock issuance costs	—	(75,960)
Exercise of stock options	401,360	—
Proceeds from stock issuance	—	8,050,000
Issuance of shares to ESOP	298,957	355,296
Purchase of treasury stock	(2,500)	(7,396)
Net cash provided by financing activities	116,348,889	102,856,150
Net increase (decrease) in cash and cash equivalents	24,861,362	52,433
Cash and cash equivalents, beginning of year	4,845,535	4,793,102
Cash and cash equivalents, end of year	$ 29,706,897	$ 4,845,535
Cash paid during the year for:		
Income taxes	$ 763,000	$ 658,331
Interest	$ 9,274,393	$ 3,761,284
Supplemental noncash investing and financing activities:		
Foreclosures on loans	$ 355,344	$ 526,475

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

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - First Reliance Bancshares, Inc. (the Company) was incorporated to serve as a bank holding company for its subsidiary, First Reliance Bank (the Bank). First Reliance Bank was incorporated on August 9, 1999 and commenced business on August 16, 1999. The principal business activity of the Bank is to provide banking services to domestic markets, principally in Florence, Lexington, and Charleston Counties in South Carolina. The Bank is a state-chartered commercial Bank, and its deposits are insured by the Federal Deposit Insurance Corporation. In 2005, the Company formed First Reliance Capital Trust I (the "Trust") for the purpose of issuing trust preferred securities. The Trust is not consolidated in these financial statements. The consolidated financial statements include the accounts of the parent company and its wholly-owned subsidiary after elimination of all significant intercompany balances and transactions.

Management's Estimates - The preparation of consolidated financial statements in conformity with generally accepted accounting principles 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, including valuation allowances for impaired loans, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowances for losses on loans and foreclosed real estate may change materially in the near term.

Concentrations of Credit Risk - Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of loans receivable, investment securities, federal funds sold and amounts due from banks.

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in Florence, Lexington, Charleston and Mount Pleasant, South Carolina. At December 31, 2005, the majority of the total loan portfolio was to borrowers from within these areas.

The Company's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to groups of borrowers or industries that would be similarly affected by economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, Management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc), and loans with high loan-to-value ratios. Management has determined that there is no concentration of credit risk associated with its lending policies or practices.

Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Company to unusual credit risk.

The Company's investment portfolio consists principally of obligations of the United States and its agencies or its corporations. In the opinion of Management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Securities Available-for-Sale - Securities available-for-sale are carried at amortized cost and adjusted to estimated market value by recognizing the aggregate unrealized gains or losses in a valuation account. Aggregate market valuation adjustments are recorded in shareholders' equity net of deferred income taxes. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis of the security. The adjusted cost basis of investments available-for-sale is determined by specific identification and is used in computing the gain or loss upon sale.

Nonmarketable Equity Securities - Nonmarketable equity securities include the cost of the Company's investment in the stock of Federal Home Loan Bank and the stock of another community bank holding company. The stock has no quoted market value and no ready market exists. Investment in the Federal Home Loan Bank is a condition of borrowing from the Federal Home Loan Bank, and the stock is pledged to collateralize such borrowings. At December 31, 2005 and 2004, the Company's investment in Federal Home Loan Bank stock was $1,627,100 and $1,614,700, respectively. Dividends received on this stock are included as a separate component of interest income. In 2003, the Company purchased $100,000 of common stock in Tidelands Bancshares, Inc., the holding company for Tidelands Bank in Mount Pleasant, South Carolina. Its investment in this stock was $100,000 at December 31, 2005 and 2004, respectively. In 2005 the company purchased $18,750 of common stock in Beach First National Bancshares, Inc. Its investment in this stock was $18,750 at December 31,2005.

Loans receivable - Loans receivable are stated at their unpaid principal balance. Interest income is computed using the simple interest method and is recorded in the period earned.

When serious doubt exists as to the collectibility of a loan or when a loan becomes contractually ninety days past due as to principal or interest, interest income is generally discontinued unless the estimated net realizable value of collateral exceeds the principal balance and accrued interest. When interest accruals are discontinued, income earned but not collected is reversed.

Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using the straight-line method.

Impaired loans are measured based on the present value of discounted expected cash flows. When it is determined that a loan is impaired, a direct charge to bad debt expense is made for the difference between the net present value of expected future cash flows based on the contractual rate and discount rate and the Company's recorded investment in the related loan. The corresponding entry is to a related allowance account. Interest is discontinued on impaired loans when management determines that a borrower may be unable to meet payments as they become due.

Allowance for Loan Losses - An allowance for loan losses is maintained at a level deemed appropriate by management to provide adequately for known and inherent risks in the loan portfolio. The allowance is based upon a continuing review of past loan loss experience, current and future economic conditions which may affect the borrowers' ability to pay and the underlying collateral value of the loans. Loans, which are deemed to be uncollectible, are charged off and deducted from the allowance. The provision for loan losses and recoveries of loans previously charged off are added to the allowance.

Residential Mortgages Held-For-Sale - The Company's mortgage activities are comprised of accepting residential mortgage loan applications, qualifying borrowers to standards established by investors, funding residential mortgages and selling mortgages to investors under pre-existing commitments. Funded residential mortgages held temporarily for sale to investors are recorded at the lower of cost or market value. Application and originations fees collected by the Company are recognized as income upon sale to the investor.

Other Real Estate Owned - Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is carried at the lower of cost (principal balance at the date of foreclosure) or fair value minus estimated costs to sell. Any write-downs at the date of foreclosure are charged to the allowance for loan losses. Expenses to maintain such assets, subsequent changes in the valuation allowance, and gains and losses on disposal are included in other expenses.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Premises, Furniture and Equipment - Premises, furniture and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method, based on the estimated useful lives for buildings of 40 years and furniture and equipment of 5 to 10 years. Leasehold improvements are being amortized over 20 years. The cost of assets sold or otherwise disposed of and the related allowance for depreciation is eliminated from the accounts and the resulting gains or losses are reflected in the income statement when incurred. Maintenance and repairs are charged to current expense. The costs of major renewals and improvements are capitalized.

Residential Mortgage Origination Fees Residential mortgage orgination fees include fees from residential mortgage loans originated by the Company and subsequently sold in the secondary market. These fees are recognized as income at the time of the sale to the investor.

Income Taxes - Income taxes are the sum of amounts currently payable to taxing authorities and the net changes in income taxes payable or refundable in future years. Income taxes deferred to future years are determined utilizing a liability approach. This method gives consideration to the future tax consequences associated with differences between financial accounting and tax bases of certain assets and liabilities which are principally the allowance for loan losses and depreciable premises and equipment.

Advertising Expense - Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expended in the period in which the direct mailings are sent. Advertising and public relations costs of $291,903 and $124,448, were included in the Company's results of operations for 2005 and 2004.

Retirement Benefits - A trusteed retirement savings plan is sponsored by the Company and provides retirement benefits to substantially all officers and employees who meet certain age and service requirements. The plan includes a "salary reduction" feature pursuant to Section 401(k) of the Internal Revenue Code. In 2004, the Company converted the 401(k) plan to a 404(c) plan. The 404 (c) plan changes investment alternatives to include the Company's stock. Under the plan and present policies, participants are permitted to make contributions up to 15% of their annual compensation. At its discretion, the Company can make matching contributions up to 6% of the participants' compensation. The Company charged $169,112 and $112,636 to earnings for the retirement savings plan in 2005 and 2004, respectively.

In 2004, the Company enacted a Stock Appreciation Rights (SARS) plan and Virtual Stock Plan which serve as deferred compensation for its executives. Both policies are based on the appreciation of the Company's stock over the executive's service period during which time the Company accrues the deferred compensation based on the number of notional shares the executive is granted. The granting of the notional shares under both plans is at the discretion of the Company's Board of Directors. Both plans have required service periods for the executives to become vested in the retirement benefits. Each plan pays out the executives over a 180 month period following their retirement. During 2004 the Company recognized $ 4,638 in compensation expense related to the Virtual Stock Plan and no expense related to the SARS Plan. During 2005 there were no expenses related to these plans and as of December 31, 2005, both the Virtual Stock Plan and SARS have been canceled.

Stock-Based Compensation - The Company has a stock-based employee compensation plan which is further described in Note 16. The Company accounts for the plan under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees,* and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all stock options granted under these plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation,* to stock-based employee compensation.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Stock-Based Compensation - *continued*

	For the years ended December 31,	
	2005	2004
Net income, as reported	$ 1,947,546	$ 1,338,699
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	767,326	234,770
Pro forma net income	$ 1,180,220	$ 1,103,929
Earnings per share:		
Basic - as reported	$ 0.60	$ 0.52
Basic - pro forma	$ 0.36	$ 0.43
Diluted - as reported	$ 0.57	$ 0.48
Diluted - pro forma	$ 0.34	$ 0.40

In calculating the pro forma disclosures, the fair value of options granted is estimated as of the date granted using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2005	2004
Dividend yield	0.00%	0.00%
Expected volatility	38.22%	44.47%
Risk-free interest rate	4.17%	4.38%
Expected life	8 years	10 years

The Financial Accounting Standards Board recently published Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123(R)"). SFAS No. 123(R), which is effective on January 1, 2006, and will require that the fair value of share-based payments to employees, including stock options, be recognized as compensation expense in the statement of income in the financial statements. Accordingly, the Company will implement the revised standard on January 1, 2006. Currently, the Company accounts for its share-based payment transactions under the provisions of APB No. 25, under which it has not recognized any compensation expense for its stock option grants and related accounting interpretations, including FASB Interpretation Number 44, "Accounting for Certain Transactions Involving Stock Compensation" ("FIN No. 44") in accounting for stock options.

On July 12, 2005, the board of directors approved accelerating the vesting of all unvested stock options. The accelerated vesting was effective as of June 30, 2005. All of the other terms and conditions applicable to the outstanding stock options remained unchanged.

The decision to accelerate vesting of these options will avoid recognition of pre-tax compensation expense by the Company upon the adoption of SFAS 123(R). In the Company's view, the future compensation expense could outweigh the incentive and retention value associated with the stock options. The future pre-tax compensation expense that will be avoided, based upon the effective date of January 1, 2006, is expected to be approximately $419,263 and $108,981 in fiscal years 2006 and 2007, respectively. The Company believes that the acceleration of vesting stock options meets the criteria for variable accounting under FIN No. 44. Based upon past experience, the Company believes the grantees of these stock options will remain as a director or employee of the Company.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - *continued*

Common Stock Owned by the 401(k) Plan and Employee Stock Ownership Plan (ESOP) - All shares held by the 401(k) and ESOP Plans, collectively referred to as the 404 (c), are treated as outstanding for purposes of computing earnings per share. 404 (C) purchases and redemptions of the Company's common stock are at estimated fair value as determined by independent valuations. Dividends on 404 (c) shares are charged to retained earnings. At December 31, 2005, the 404 (c) owned 66,991 shares of the Company's common stock with an estimated value of $1,038,361. At December 31, 2004, the 404 (c) owned 38,782 shares of the Company's common stock with an estimated value of $486,714. All of these shares were allocated. Contributions to the 404 (c) in 2005 and 2004 were $169,112 and $112,636, respectively.

Earnings Per Share - Basic earnings per share represents income available to shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method (see Note 15).

Comprehensive Income - Accounting principles generally require that recognized income, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	For the years ended December 31,	
	2005	2004
Unrealized gains (losses) on securities available-for-sale:	$ (535,420)	$ (7,014)
Reclassification adjustment for gains realized in net income	—	(5,971)
Net unrealized gains (losses) on securities	(535,420)	(12,985)
Tax effect	182,043	8,356
Net-of-tax amount	$ (353,377)	$ (4,629)

Statements of Cash Flows - For purposes of reporting cash flows in the consolidated financial statements, the Company considers certain highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks and federal funds sold. Generally, federal funds are sold for one-day periods.

Changes in the valuation account of securities available-for-sale, including the deferred tax effects, are considered noncash transactions for purposes of the statement of cash flows and are presented in detail in the notes to the consolidated financial statements.

Off-Balance-Sheet Financial Instruments - In the ordinary course of business, the Company enters into off-balance-sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the consolidated financial statements when they become payable by the customer.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES- *continued*

Recent Accounting Pronouncements - The following is a summary of recent authoritative pronouncements that affect accounting, reporting, and disclosure of financial information by the Company:

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *"Share-Based Payment"* ("SFAS No. 123(R)"). SFAS No. 123(R) will require companies to measure all employee stock-based compensation awards using a fair value method and record such expense in its financial statements. In addition, the adoption of SFAS No. 123(R) requires additional accounting and disclosures related to the income tax and cash flow effects resulting from share-based payment arrangements. SFAS No. 123(R) is effective beginning as of the first annual reporting period beginning after December 15, 2005. SFAS No. 123(R) allows for adoption using either the modified prospective or modified retrospective methods. The Company anticipates using the modified prospective method when this statement is adopted in the first quarter of 2006. The Company has evaluated the impact upon adoption of SFAS No. 123(R) and has concluded that the adoption will not have a material impact on financial position or results of operations upon adoption.

In April 2005, the Securities and Exchange Commission's Office of the Chief Accountant and its Division of Corporation Finance issued Staff Accounting Bulletin ("SAB") No. 107 to provide guidance regarding the application of SFAS No. 123 (R). SAB No. 107 provides interpretive guidance related to the interaction between SFAS No. 123(R) and certain SEC rules and regulations, as well as the staff's views regarding the valuation of share-based payment arrangements for public companies. SAB No. 107 also reminds public companies of the importance of including disclosures within filings made with the SEC relating to the accounting for share-based payment transactions, particularly during the transition to SFAS No. 123 (R).

In December 2004, the FASB issued SFAS No. 153, *"Exchanges of Nonmonetary Assets - an amendment of APB Opinion No. 29"*. The standard is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged and eliminates the exception under ABP Opinion No. 29 for an exchange of similar productive assets and replaces it with an exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The standard is effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS 153 is not expected to have a material impact on the Company's financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, *"Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3"*. SFAS No. 154 establishes retrospective application as the required method for reporting a change in accounting principle, unless it is impracticable, in which case the changes should be applied to the latest practicable date presented. SFAS No. 154 also requires that a correction of an error be reported as a prior period adjustment by restating prior period financial statements. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005.

In March 2004, the FASB issued Emerging Issues Task Force ("EITF") Issue No. 03-1, *"The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments"*. This issue addresses the meaning of other-than-temporary impairment and its application to investments classified as either available for sale or held to maturity under SFAS No. 115 and it also provides guidance on quantitative and qualitative disclosures. The disclosure requirements in paragraph 21 of this Issue were effective for annual financial statements for fiscal years ending after December 15, 2003 and were adopted by the Company effective December 31, 2003.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES - *continued*

Recent Accounting Pronouncements *(continued)* - The recognition and measurement guidance in paragraphs 6-20 of this Issue was to be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004, but was delayed by FASB action in October 2004 through the issuance of a proposed FASB Staff Position ("FSP") on the issue. In July 2005, the FASB issued FSP FAS 115-1 and FAS 124-1 - *"The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments"*. This final guidance eliminated paragraphs 10-18 of EITF-03-1 (paragraphs 19-20 have no material impact on the financial position or results of operations of the Company) and will be effective for other-than-temporary impairment analysis conducted in periods beginning after December 15, 2005. The Company has evaluated the impact that the adoption of FSP FAS 115-1 and FAS 124-1 and has concluded that the adoption will not have a material impact on financial position and results of operations upon adoption.

In December 2005, the FASB issued FSP SOP 94-6-1, *"Terms of Loan Products that May Give Rise to a Concentration of Credit Risk"*. The disclosure guidance in this FSP is effective for interim and annual periods ending after December 19, 2005. The FSP states that the terms of certain loan products may increase a reporting entity's exposure to credit risk and thereby may result in a concentration of credit risk as that term is used in SFAS No. 107, either as an individual product type or as a group of products with similar features. SFAS No. 107 requires disclosures about each significant concentration, including "information about the (shared) activity, region, or economic characteristic that identifies the concentration." The FSP suggests possible shared characteristics on which significant concentrations may be determined which include, but are not limited to borrowers subject to significant payment increases, loans with terms that permit negative amortization and loans with high loan-to-value ratios.

This FSP requires entities to provide the disclosures required by SFAS No. 107 for loan products that are determined to represent a concentration of credit risk in accordance with the guidance of this FSP for all periods presented. The Company adopted this disclosure standard effective December 31, 2005.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

Risks and Uncertainties - In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

Reclassifications - Certain captions and amounts in the 2004 consolidated financial statements were reclassified to conform with the 2005 presentation.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 2 - CASH AND DUE FROM BANKS

The Company is required to maintain balances with The Federal Reserve computed as a percentage of deposits. At December 31, 2005 and 2004, this requirement was $ 1,205,000 and $1,105,000, respectively. This requirement was met by vault cash and balances on deposit with the Federal Reserve.

NOTE 3 - INVESTMENT SECURITIES

The amortized cost and estimated fair values of securities available-for-sale were:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2005				
U.S. Government agencies	$ 9,553,869	$ —	$ 114,625	$ 9,439,244
Mortgage-backed securities	13,790,202	17,682	378,270	13,429,614
Municipals	13,947,622	327,337	22,338	14,252,621
	$ 37,291,693	$ 345,019	$ 515,233	$ 37,121,479
December 31, 2004				
U.S. Government agencies	$ 2,424,872	$ 49,176	$ —	$ 2,474,048
Mortgage-backed securities	14,863,372	29,954	110,661	14,782,665
Municipals	10,914,216	398,036	1,299	11,310,953
	$ 28,202,460	$ 477,166	$ 111,960	$ 28,567,666

There were no sales of securities available-for-sale during 2005. For the year ended December 31, 2004, proceeds from the sales of securities available-for-sale amounted to $5,976,385. Gross realized gains amounted to $5,971 for the year ended December 31, 2004. There were no gross realized losses.

The following is a summary of maturities of securities available-for-sale as of December 31, 2005. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

	Securities Available-For-Sale	
	Amortized Cost	Estimated Fair Value
Due after one year but within five years	$ 6,155,886	$ 6,086,015
Due after five years but within ten years	1,283,706	1,283,230
Due after ten years	16,061,899	16,322,620
	23,501,491	23,691,865
Mortgage-backed securities	13,790,202	13,429,614
Total	$ 37,291,693	$ 37,121,479

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 3 - INVESTMENT SECURITIES - *continued*

The following table shows gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2005.

Securities Available for Sale

	Less than twelve months		Twelve months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. government agencies	$ 9,439,244	$ 114,625	$ —	$ —	$ 9,439,244	$ 114,625
Municipals	2,298,360	22,338	—	—	2,298,360	22,338
Mortgage-backed securities	1,241,120	16,644	10,232,228	361,626	11,473,348	378,270
Total	$ 12,978,724	$ 153,607	$ 10,232,228	$ 361,626	$ 23,210,952	$ 515,233

Securities classified as available-for-sale are recorded at fair market value. Approximately 71% of the unrealized losses, or seven individual securities, consisted of securities in a continuous loss position for twelve months or more. The Company has the ability and intent to hold these securities until such time as the value recovers or the securities mature. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and is not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

At December 31, 2005 and 2004, securities with amortized costs of $6,249,272 and $13,485,307 and estimated fair values of $6,197,672 and $13,634,554 , respectively, were pledged to secure public deposits and for other purposes as required and permitted by law.

NOTE 4 - LOANS RECEIVABLE

Major classifications of loans receivable are summarized as follows:

	December 31, 2005	December 31, 2004
Mortgage loans on real estate:		
Residential 1-4 family	$ 50,937,658	$ 50,429,754
Multifamily	6,322,957	2,786,453
Commercial	106,125,103	63,188,726
Construction	52,267,759	39,023,385
Second mortgages	4,885,095	5,311,537
Equity lines of credit	24,570,163	14,179,437
	245,108,735	174,919,292
Commercial and industrial	50,320,434	47,890,104
Consumer	13,953,632	13,931,133
Other	2,161,584	1,621,563
Total gross loans	$ 311,544,385	$ 238,362,092

The Company has pledged certain loans as collateral to secure its borrowings from the Federal Home Loan Bank. The total of loans pledged was $211,589,263 at December 31, 2005 (see Note 8).

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 4 - LOANS RECEIVABLE - *continued*

The Company identifies impaired loans through its normal internal loan review process. Loans on the Company's problem loan watch list are considered potentially impaired loans. These loans are evaluated in determining whether all outstanding principal and interest are expected to be collected. Loans are not considered impaired if a minimal delay occurs and all amounts due including accrued interest at the contractual interest rate for the period of delay are expected to be collected. At December 31, 2005, impaired loans totaled $2,778,090, and specific write downs on these loans totaled $218,287. Accrued interest related to these loans totaled $23,053. At December 31, 2004, management believes that impaired loans closely approximated nonaccrual loans.

Transactions in the allowance for loan losses are summarized below:

	For the years ended December 31,	
	2005	2004
Balance, beginning of year	$ 2,758,225	$ 1,752,282
Provision charged to operations	1,811,317	1,361,762
Recoveries on loans previously charged-off	81,813	35,156
Loans charged-off	(1,231,987)	(390,975)
Balance, end of year	$ 3,419,368	$ 2,758,225

As of December 31, 2005, there were $704,800 in loans past due ninety days or more and still accruing interest and $1,792,702 in loans on nonaccrual status. There were $59,148 in loans past due ninety days or more and still accruing interest and $1,186,183 in loans in nonaccrual status at December 31, 2004.

Loans sold with limited recourse are 1-4 family residential mortgages originated by the Company and sold to various other financial institutions. These loans are sold with the agreement that a loan may be returned to the Company at any time in the event the Company fails to provide necessary documents related to the mortgages to the buyers, or if it makes false representations or warranties to the buyers. Loans sold under these agreements in 2005 total $67,798,201. The Company uses the same credit policies in making loans held for sale as it does for on-balance-sheet instruments.

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist of commitments to extend credit and standby letters of credit. 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. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by the other party to the instrument is represented by the contractual notional amount of the instrument. Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments to extend credit as it does for on-balance-sheet instruments. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities.

Collateral held for commitments to extend credit and standby letters of credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

The following table summarizes the Company's off-balance-sheet financial instruments whose contract amounts represent credit risk:

December 31,

		2005		2004
Commitments to extend credit	$	59,196,000	$	31,702,000
Standby letters of credit		1,699,000		720,000

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 5 - PREMISES, FURNITURE AND EQUIPMENT

Premises, furniture and equipment consisted of the following:

	December 31,	
	2005	2004
Land	$ 4,655,609	$ 1,305,609
Building	4,066,613	4,048,181
Leasehold improvements	117,197	117,197
Furniture and equipment	2,262,900	1,881,453
Construction in progress	1,017,947	22,552
Total	12,120,266	7,374,992
Less, accumulated depreciation	2,099,729	1,483,590
Premises and equipment, net	$ 10,020,537	$ 5,891,402

Depreciation expense for the years ended December 31, 2005 and 2004 amounted to $658,255 and $548,822, respectively.

Construction in process consists of renovations to the Company's corporate office and architect fees and site work for the Lexington and Mount Pleasant branches.

NOTE 6 - DEPOSITS

At December 31, 2005, the scheduled maturities of time deposits were as follows:

Maturing In	Amount
2006	$ 134,481,951
2007	34,064,131
2008	11,635,457
2009	5,291,138
2010	641,365
Total	$ 186,114,042

Included in total time deposits at December 31, 2005 and 2004 were brokered time deposits of $39,213,743 and $51,598,000, respectively.

NOTE 7 - SHORT-TERM BORROWINGS

Short-term borrowings payable are securities sold under agreements to repurchase which generally mature on a one to thirty day basis. Information concerning securities sold under agreements to repurchase is summarized as follows:

	For the years ended December 31,	
	2005	2004
Balance at end of the year	$ 3,859,904	$ 3,061,903
Average balance during the year	3,599,716	2,460,237
Average interest rate during the year	2.54%	0.83%
Maximum month-end balance during the year	4,223,149	3,061,903

Under the terms of the repurchase agreement, the Company sells an interest in securities issued by United States Government agencies and agrees to repurchase the same securities the following business day. As of December 31, 2005 and 2004, the par value and market value of the securities held by the third-party for the underlying agreements were $4,818,637 and $4,901,635, respectively, and $4,791,987 and $4,833,784, respectively.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 8 - ADVANCES FROM FEDERAL HOME LOAN BANK

Advances from the Federal Home Loan Bank consisted of the following:

		December 31,	
Description	Interest Rate	2005	2004
Fixed rate advances maturing:			
January 18, 2005	2.24%	$ —	$ 500,000
April 8, 2005	2.04%	—	1,000,000
July 1, 2005	4.12%	—	500,000
February 3, 2006	3.40%	5,000,000	—
April 10, 2006	2.60%	1,000,000	1,000,000
September 12, 2006	2.66%	—	3,500,000
December 19, 2006	2.87%	1,500,000	1,500,000
January 12, 2007	3.72%	2,000,000	—
April 9, 2007	3.13%	1,000,000	1,000,000
July 2, 2007	3.56%	500,000	500,000
December 19, 2007	3.44%	1,500,000	1,500,000
April 8, 2008	3.46%	1,000,000	1,000,000
March 19, 2009	2.48%	3,000,000	3,000,000
December 10, 2009	2.56%	—	4,000,000
January 17, 2012	3.83%	—	1,000,000
March 10, 2015	3.44%	6,000,000	—
July 5, 2012	4.08%	1,000,000	—
Variable rate advances maturing:			
March 25, 2006	2.44%	—	6,900,000
July 5, 2012	4.08%	—	1,000,000
		$ 23,500,000	$ 27,900,000

Scheduled principal reductions of Federal Home Loan Bank advances are as follows:

	Amount
2006	$ 7,500,000
2007	5,000,000
2008	1,000,000
2009	3,000,000
2010	—
Thereafter	7,000,000
Total	$ 23,500,000

As collateral, the Company had pledged blanket liens on its first mortgage one to four family loans, its multifamily residential property loans, and its revolving, open-end loans secured by 1-4 family residential properties and extended under lines of credit. The aggregate balance of these loan types was $211,589,263 (see Note 4) at December 31, 2005. In addition, the Company's Federal Home Loan Bank stock is pledged to secure the borrowings. Certain advances are subject to prepayment penalties.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 9 - JUNIOR SUBORDINATED DEBENTURES

On June 30, 2005 the Company formed First Reliance Capital Trust I (the "Trust") for the purposed of issuing trust preferred securities, which enable the Company to obtain Tier 1 capital on a consolidated basis for regulatory purposes. On July 1, 2005, the Company closed a private offering of $10,000,000 of floating rate preferred securities offered and sold by the Trust. The proceeds from such issuance, together with the proceeds from a related issuance of common securities of the Trust purchased by the Company in the amount of $310,000, were invested by the Trust in floating rate Junior Subordinated Debentures issued by the Company (the "Debentures") totaling $10,310,000. The Debentures are due and payable on November 23, 2035 and may be redeemed by the Company after five years, and sooner in certain specific events, including in the event that certain circumstances render the Debentures ineligible for treatment as Tier 1 capital, subject to prior approval by the Federal Reserve Board, if then required. The Debentures presently qualify as Tier 1 capital for regulatory reporting. The sole assets of the Trust are the Debentures. The Company owns 100% of the common securities of the Trust. The Debentures are unsecured and rank junior to all senior debt of the Company. At December 31, 2005, the floating rate preferred securities and the Debentures had an annual interest rate of 5.93%. This interest rate is fixed until August 23, 2010, when the interest rate will adjust quarterly. After August 23, 2010, the interest rate will equal three-month LIBOR plus 1.83%.

NOTE 10 - RESTRICTIONS ON SHAREHOLDERS' EQUITY

South Carolina banking regulations restrict the amount of dividends that can be paid to shareholders. All of the Bank's dividends to First Reliance Bancshares, Inc. are payable only from the undivided profits of the Bank. At December 31, 2005, the Bank had undivided profits of $5,623,976. The Bank is authorized to upstream 100% of net income in any calendar year without obtaining the prior approval of the Commissioner of Banking provided that the Bank received a composite rating of one or two at the last Federal or State regulatory examination. Under Federal Reserve Board regulations, the amounts of loans or advances from the Bank to the parent company are also restricted.

NOTE 11 - OTHER OPERATING EXPENSES

Other operating expenses are summarized below:

	For the years ended December 31,	
	2005	2004
Professional fees	$ 377,356	$ 193,034
Office supplies, forms, and stationery	224,235	144,798
Advertising	291,903	124,448
Data processing and supplies	20,616	12,597
Employee education and conventions	60,015	48,502
Computer supplies and software amortization	483,168	342,487
Telephone	153,922	121,249
Directors fees	138,600	91,100
Other	1,957,358	1,343,820
Total	$ 3,707,173	$ 2,422,035

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 12 - INCOME TAXES

Income tax expense is summarized as follows:

	For the years ended December 31, 2005	2004
Currently payable		
Federal	$ 828,285	$ 707,796
State	97,745	66,667
Total current	926,030	774,463
Deferred income taxes	(318,657)	(206,314)
Total income tax expense	$ 607,373	$ 568,149
Income tax expense is allocated as follows:		
To continuing operations	$ 789,416	$ 570,533
To shareholders' equity	(182,043)	(2,384)
	$ 607,373	$ 568,149

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

	December 31, 2005	2004
Deferred tax assets:		
Allowance for loan losses	$ 914,956	$ 814,656
Organizational costs	6,013	15,349
Deferred compensation	65,027	—
Unrealized loss on securities available for sale	58,508	—
Other	35,882	26,996
Total gross deferred tax assets	1,080,386	857,001
Deferred tax liabilities:		
Unrealized gain on securities available-for-sale	—	123,535
Accumulated depreciation	180,792	241,387
Prepaid expenses	57,232	—
Other	31,626	—
Total gross deferred tax liabilities	269,650	364,922
Net deferred tax asset recognized	$ 810,736	$ 492,079

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. As of December 31, 2005, management has determined that it is more likely than not that the total deferred tax asset will be realized and, accordingly, has not established a valuation allowance. Net deferred tax assets are included in other assets at December 31, 2005 and 2004.

A reconciliation between the income tax expense and the amount computed by applying the federal statutory rate of 34% to income before income taxes follows:

	For the years ended December 31,			
	2005		2004	
Tax expense at statutory rate	$	930,567	$	649,139
State income tax, net of federal income tax benefit		64,512		40,785
Tax-exempt interest income		(188,419)		(141,973)
Disallowed interest expense		21,503		11,918
Other, net		(38,747)		10,664
	$	**789,416**	$	**570,533**

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 13 - RELATED PARTY TRANSACTIONS

Certain parties (principally certain directors and executive officers of the Company, their immediate families and business interests) were loan customers of and had other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectibility. As of December 31, 2005 and 2004, the Company had related party loans totaling $1,499,117 and $1,516,176, respectively. During 2005, $32,770 of advances were made to related parties and repayments totaled $49,829. During 2004, $91,806 of advances were made to related parties and repayments totaled $902,220.

At December 31, 2005 and 2004, the Company had securities sold under agreements to repurchase with related parties of $2,740,443 and $2,007,734, respectively.

Deposits from directors and executive officers and their related interests totaled $4,663,922 and $3,217,322 at December 31, 2005 and 2004, respectively.

During 2005, the Company entered into a lease agreement with SP Financial LLC (The LLC), a limited liability company owned 50% each by two of the Bank's executive officers. The LLC obtained third party financing to purchase the property to be leased to the Bank. The debt related to this property is guaranteed by these officers but not by the Company. Additionally, the Company has no investment risk related to the property, and has a valid lease agreement which will remain in place even if an ownership transfer occurs. For these reasons the LLC is not considered a Variable Interest Entity under FIN 46(R), and its financial statements have not been consolidated with the Company's. The lease has an initial five year term and is included in the total future rental payments discussed in Note 14.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Company may, from time to time, become a party to legal claims and disputes. At December 31, 2005, management and legal counsel are not aware of any pending or threatened litigation or unasserted claims or assessments that could result in losses, if any, that would be material to the consolidated financial statements.

The Company has entered into six separate lease agreements for properties in Florence, Charleston, Mount Pleasant and Lexington, South Carolina for branch banking and mortgage operations. The leases have various initial terms and expire on various dates. The lease agreements generally provide that the Bank is responsible for ongoing repairs and maintenance, insurance and real estate taxes. The leases also provide for renewal options and certain scheduled increases in monthly lease payments. Rental expenses recorded under leases for the years ended December 31, 2005 and 2004 were $341,339 and $33,000, respectively.

Under this scenario, minimal future rental payments under non-cancelable operating leases having remaining terms in excess of one year, for each of the next five years in the aggregate are:

2006	$	491,587
2007		382,578
2008		363,000
2009		363,000
2010		363,000
	$	**1,963,165**

On January 19, 2006, the Company's Board of Directors approved plans to purchase property and construct or renovate buildings at several locations for future branch and administrative sites. Future costs related to these plans are estimated to be approximately $8.9 million.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 15 - EARNINGS PER SHARE

Earnings per share - basic is computed by dividing net income by the weighted average number of common shares outstanding. Earnings per share - diluted is computed by dividing net income by the weighted average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding stock options.

	For the years ended December 31, 2005	2004
Basic earnings per share:		
Net income available to common shareholders	$ 1,947,546	$ 1,338,699
Average common shares outstanding - basic	3,251,457	2,580,251
Basic earnings per share	$ 0.60	$ 0.52
Diluted earnings per share:		
Net income available to common shareholders	$ 1,947,546	$ 1,338,699
Average common shares outstanding - basic	3,251,457	2,580,251
Incremental shares from assumed conversion of stock options	185,293	182,636
Average common shares outstanding - diluted	3,436,750	2,762,887
Diluted earnings per share	$ 0.57	$ 0.48

NOTE 16 - STOCK COMPENSATION PLAN

On June 19, 2003, the Company established the 2003 First Reliance Bank Employee Stock Option Plan (Stock Plan) that provides for the granting of options to purchase up to 250,000 shares of the Company's common stock to directors, officers, or employees of the Company. This plan was preceded by the 1999 First Reliance Bank Employee Stock Option Plan, which provided for the granting of options to purchase up to 238,000 shares of the Company's common stock to directors, officers, or employees of the Company. The per-share exercise price of incentive stock options granted under the Stock Plan may not be less than the fair market value of a share on the date of grant. The per-share exercise price of stock options granted is determined by the Board of Directors. The expiration date of any option may not be greater than ten years from the date of grant. Options that expire unexercised or are canceled become available for reissuance. At December 31, 2005, there were no options available for grant under the 2003 plan and no options available for grant under the 1999 plan.

A summary of the status of the Company's stock option plan as of December 31, 2005 and 2004, and changes during the period is presented below:

	2005 Shares	2005 Weighted-Average Exercise Price	2004 Shares	2004 Weighted-Average Exercise Price
Outstanding at beginning of year	409,063	$ 6.59	390,918	$ 6.38
Granted	70,300	11.51	18,145	11.15
Exercised	(79,000)	5.08	—	
Expired	—		—	
Outstanding at end of year	400,363	7.75	409,063	6.59

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 16 - STOCK COMPENSATION PLAN - *continued*

The following table summarizes information about stock options outstanding under the Company's plan at December 31, 2005:

	Outstanding	Exercisable
Number of options	400,363	400,363
Weighted average remaining life	6.61	6.61
Weighted average exercise price	$ 7.75	$ 7.75
High exercise price	$ 11.43	$ 11.43
Low exercise price	$ 5.12	$ 5.12

NOTE 17 - 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 material effect on the Company's 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 the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classifications 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 Company and the Bank to maintain minimum ratios (set forth in the table below) of Tier 1 and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 100%. Tier 1 capital of the Company and the Bank consists of common shareholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

The Company and the Bank are also required to maintain capital at a minimum level based on average assets (as defined), which is known as the leverage ratio. Only the strongest institutions are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

As of the most recent regulatory examination, the Bank was deemed well-capitalized under the regulatory framework for prompt corrective action. To be categorized well capitalized, the Bank must maintain total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events that management believes have changed the Bank's categories.

The following table summarizes the capital amounts and ratios of the Company and the Bank and the regulatory minimum requirements.

	Actual		Minimum Requirement For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2005						
The Company						
Total capital (to risk-weighted assets)	$ 43,491,000	13.05%	$ 26,670,800	8.00%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	40,072,000	12.02	13,335,400	4.00	N/A	N/A
Tier 1 capital (to average assets)	40,072,000	10.02	15,998,080	4.00	N/A	N/A
The Bank						
Total capital (to risk-weighted assets)	$ 42,199,000	12.68%	$ 26,625,200	8.00%	$ 33,281,500	10.00%

Tier 1 capital (to risk-weighted assets)	38,780,000	11.65	13,312,600	4.00	19,968,900	6.00
Tier 1 capital (to average assets)	38,780,000	9.80	15,832,040	4.00	19,790,050	5.00

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 17 - REGULATORY MATTERS - *continued*

	Actual		Minimum Requirement For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2004						
The Company						
Total capital (to risk-weighted assets)	$ 29,875,000	12.52%	$ 19,093,680	8.00%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	27,117,000	11.36	9,546,840	4.00	N/A	N/A
Tier 1 capital (to average assets)	27,117,000	10.11	10,729,280	4.00	N/A	N/A
The Bank						
Total capital (to risk-weighted assets)	$ 24,392,000	10.23%	$ 19,084,000	8.00%	$ 23,855,000	10.00%
Tier 1 capital (to risk-weighted assets)	21,634,000	9.07	9,542,000	4.00	14,313,000	6.00
Tier 1 capital (to average assets)	21,634,000	8.07	10,729,280	4.00	13,411,600	5.00

NOTE 18 - UNUSED LINES OF CREDIT

As of December 31, 2005, the Company had unused lines of credit to purchase federal funds from unrelated companies totaling $33,500,000. These lines of credit are available on a one to fourteen day basis for general corporate purposes. The Company also has a line of credit to borrow funds from the Federal Home Loan Bank of up to $121,044,000. As of December 31, 2005 and 2004, the Company had borrowed $23,500,000 and $27,900,000, respectively, on this line. Additionally, the Company has the ability to buy brokered time deposits at December 31, 2005.

NOTE 19 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount for which the asset or obligation could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instruments. Because no market value exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and Due from Banks - The carrying amount is a reasonable estimate of fair value.

Federal Funds Sold and Purchased - Federal funds sold and purchased are for a term of one day and the carrying amount approximates the fair value.

Securities Available-for-Sale - Fair value equals the carrying amount which is the quoted market price. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities.

Nonmarketable Equity Securities - The carrying amount of nonmarketable equity securities is a reasonable estimate of fair value since no ready market exists for these securities.

Loans Held-for-Sale - The carrying amount of loans held for sale is a reasonable estimate of fair value.

Loans Receivable - For certain categories of loans, such as variable rate loans which are repriced frequently and have no significant change in credit risk and credit card receivables, fair values are based on the carrying amounts. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to the borrowers with similar credit ratings and for the same remaining maturities.

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 19 - FAIR VALUE OF FINANCIAL INSTRUMENTS - *continued*

Deposits - The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

Securities Sold Under Agreements to Repurchase - The carrying amount is a reasonable estimate of fair value because these instruments typically have terms of one day.

Advances From Federal Home Loan Bank - The fair values of fixed rate borrowings are estimated using a discounted cash flow calculation that applies the Company's current borrowing rate from the Federal Home Loan Bank. The carrying amounts of variable rate borrowings are reasonable estimates of fair value because they can be repriced frequently.

Junior Subordinated Debentures - The carrying value of junior subordinated debentures approximates its fair value since the debentures were issued at a floating rate.

Accrued Interest Receivable and Payable - The carrying value of these instruments is a reasonable estimate of fair value.

Off-Balance-Sheet Financial Instruments - Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

The carrying values and estimated fair values of the Company's financial instruments were as follows:

	December 31,			
	2005		2004	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets:				
Cash and due from banks	$ 7,264,897	$ 7,264,897	$ 3,803,535	$ 3,803,535
Federal funds sold	22,442,000	22,442,000	1,042,000	1,042,000
Securities available-for-sale	37,121,479	37,121,479	28,567,666	28,567,666
Nonmarketable equity securities	1,745,850	1,745,850	1,714,700	1,714,700
Loans, including loans held for sale	319,538,988	314,694,000	239,694,982	236,534,744
Accrued interest receivable	2,189,742	2,189,742	1,458,673	1,458,673
Financial Liabilities:				
Demand deposit, interest-bearing transaction, and savings accounts	$ 148,322,856	$ 148,322,856	$ 89,385,369	$ 89,385,369
Certificates of deposit	186,114,042	186,472,000	136,108,458	136,642,893
Securities sold under agreements to repurchase	3,859,904	3,859,904	3,061,903	3,061,903
Advances from Federal Home Loan Bank	23,500,000	23,372,000	27,900,000	26,834,409
Junior subordinated debentures	10,310,000	10,310,000	—	—
Accrued interest payable	446,303	446,303	742,017	742,017

	Notional Amount	Estimated Fair Value	Notional Amount	Estimated Fair Value
Off-Balance-Sheet Financial Instruments:				
Commitments to extend credit	$ 59,195,691	$ —	$ 31,702,000	$ —
Standby letters of credit	1,699,307	—	720,000	—

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 20 - FIRST RELIANCE BANCSHARES, INC. (PARENT COMPANY ONLY)

Condensed Balance Sheets

	December 31, 2005	December 31, 2004
Assets		
Cash	$ 739,230	$ 5,325,224
Investment in banking subsidiary	38,668,573	21,875,795
Nonmarketable equity securities	118,750	100,000
Investment in trust	310,000	—
Other assets	188,876	57,630
Total assets	$ 40,025,429	$ 27,358,649
Liabilities		
Accounts payable	$ 64,794	$ —
Junior subordinated debentures	10,310,000	—
Total liabilities	10,374,794	—
Shareholders' equity	29,650,635	27,358,649
Total liabilities and shareholders' equity	$ 40,025,429	$ 27,358,649

Condensed Statements of Income

	December 31, 2005	December 31, 2004
Income	7,264	$ —
Expenses	367,981	54,783
Income (loss) before income taxes and equity in undistributed earnings of banking subsidiary	(360,717)	(54,783)
Income tax benefit	136,148	20,270
Income before equity in undistributed earning of banking subsidiary	(224,569)	(34,513)
Equity in undistributed earnings of banking subsidiary	2,172,115	1,373,212
Net income	$ 1,947,546	$ 1,338,699

FIRST RELIANCE BANCSHARES, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

NOTE 20 - FIRST RELIANCE BANCSHARES, INC. (PARENT COMPANY ONLY) - *continued*

Condensed Statements of Cash Flows

	December 31, 2005	December 31, 2004
Cash flows from operating activities		
Net income	$ 1,947,546	$ 1,338,699
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in other assets	(131,246)	(6,175)
Increase in other liabilities	64,794	—
Equity in undistributed earnings of banking subsidiary	(2,172,115)	(1,373,212)
Net cash used by operating activities	(291,021)	(40,688)
Cash flows from investing activities		
Purchase of nonmarketable equity securities	(18,750)	—
Investment in trust	(310,000)	—
Net cash used by investing activities	(328,750)	—
Cash flows from financing activities		
Stock issuance costs	—	(75,960)
Proceeds from exercise of stock options	401,360	—
Proceeds from stock issuance	—	8,050,000
Issuance of shares to ESOP	298,957	355,296
Purchase of treasury stock	(2,500)	(7,396)
Proceeds from issuance of junior subordinated debentures	10,310,000	—
Transfer of capital to the Bank	(14,974,040)	(3,000,000)
Net cash provided (used) by financing activities	(3,966,223)	5,321,940
(Decrease) increase in cash	(4,585,994)	5,281,252
Cash and cash equivalents, beginning of year	5,325,224	43,972
Cash and cash equivalents, ending of year	$ **739,230**	$ **5,325,224**

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Balance Sheets

	March 31, 2008 (Unaudited)	December 31, 2007 (Audited)
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 7,929,684	$ 7,164,650
Securities available-for-sale	57,630,118	58,580,313
Nonmarketable equity securities	4,372,200	3,930,400
Total investment securities	62,002,318	62,510,713
Loans held for sale	18,403,137	19,600,850
Loans receivable	473,069,194	468,137,690
Less allowance for loan losses	(5,539,601)	(5,270,607)
Loans, net	467,529,593	462,867,083
Premises and equipment, net	23,713,588	22,233,746
Accrued interest receivable	2,977,560	3,092,767
Other real estate owned	327,950	196,950
Cash surrender value life insurance	10,662,027	10,540,273
Other assets	4,047,044	3,497,180
Total assets	$ 597,592,901	$ 591,704,212
Liabilities and Shareholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing transaction accounts	$ 45,178,443	$ 43,542,528
Interest-bearing transaction accounts	31,058,228	39,450,393
Savings	90,229,421	85,819,481
Time deposits $100,000 and over	185,683,283	169,825,252
Other time deposits	97,861,715	110,860,061
Total deposits	450,011,090	449,497,715
Securities sold under agreement to repurchase	7,858,845	7,927,754
Federal funds purchased	11,482,000	13,359,000
Advances from Federal Home Loan Bank	73,500,000	69,000,000
Note payable	3,000,000	3,000,000
Junior subordinated debentures	10,310,000	10,310,000
Accrued interest payable	684,067	767,577
Other liabilities	2,960,384	814,262
Total liabilities	559,806,386	554,676,308
Shareholders' Equity		
Common stock, $0.01 par value; 20,000,000 shares authorized, 3,513,174 and 3,494,646 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively	35,132	34,946
Nonvested restricted stock	(273,344)	(152,762)
Capital surplus	26,047,924	25,875,012
Treasury stock (10,571 shares at cost at December 31, 2007)	(156,975)	(145,198)
Retained earnings	12,039,496	11,417,275
Accumulated other comprehensive income	94,282	(1,369)
Total shareholders' equity	37,786,515	37,027,904
Total liabilities and shareholders' equity	$ 597,592,901	$ 591,704,212

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Income
(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Interest income		
Loans, including fees	$ 9,099,475	$ 7,892,673
Investment securities		
Taxable	346,384	234,334
Nontaxable	327,610	170,141
Federal funds sold	1,893	78,659
Other interest income	51,290	40,305
Total	9,826,652	8,416,112
Interest expense		
Time deposits over $100,000	2,037,053	1,392,470
Other deposits	1,902,095	2,187,668
Other interest expense	919,520	447,293
Total	4,858,668	4,027,431
Net interest income	4,967,984	4,388,681
Provision for loan losses	501,603	135,234
Net interest income after provision for loan losses	4,466,381	4,253,447
Noninterest income		
Service charges on deposit accounts	437,135	442,670
Gain on sale of mortgage loans	559,384	470,242
Brokerage fees	50,330	40,860
Income from bank owned life insurance	121,754	100,740
Other charges, commissions and fees	113,272	77,762
Gain on securities available for sale	-	1,021
Gain (loss) on sale of other real estate	-	9,365
Gain on sale of fixed assets	-	14,415
Other non-interest income	49,919	36,110
Total	1,331,794	1,193,185
Noninterest expenses		
Salaries and benefits	2,944,751	2,595,775
Occupancy expense	339,703	337,396
Furniture and equipment expense	212,959	190,661
Other operating expenses	1,236,983	1,381,410
Total	4,734,396	4,505,242
Income before taxes	1,063,779	941,390
Income tax provision	237,656	234,183
Net income	$ 826,123	$ 707,207
Basic earnings per share	$ 0.24	$ 0.21
Diluted earnings per share	$ 0.23	$ 0.20

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Shareholders' Equity and Comprehensive Income
For the Three Months Ended March 31, 2008 and 2007
(Unaudited)

	Common Stock Shares	Common Stock Amount	Capital surplus	Non-vested restricted stock	Treasury stock	Retained earnings	Accumulated other comprehensive income	Total
Balance, December 31, 2006	3,424,878	$ 34,249	$ 25,257,814	$ (66,131)	$ -	$ 8,857,755	$ 9,576	$ 34,093,263
Net income						707,208		707,208
Other comprehensive gain, net of tax expense of $18,200							35,330	35,330
Comprehensive income								742,538
Issuance of shares to 404c plan	9,750	97	143,715					143,812
Non- vested restricted stock	4,002	40	59,996	(46,815)				13,220
Exercise of stock options	21,000	210	106,375					106,585
Balance, March 31, 2007	3,459,630	$ 34,596	$ 25,567,900	$ (112,946)	$ -	$ 9,564,963	$ 44,906	$ 35,099,419
Balance, December 31, 2007	3,494,646	$ 34,946	$ 25,875,012	$ (152,762)	$ (145,198)	$ 11,417,275	$ (1,369)	$ 37,027,904
Adjustment to reflect the cumulative-effect of change accounting for Life insurance arrangements					(203,902)			(203,902)
Balance, December 31, 2007	3,494,646	34,946	25,875,012	(152,762)	(145,198)	11,213,373	(1,369)	36,824,002
Net income						826,123		826,123
Other comprehensive gain, net of tax expense of 49,275							95,651	95,651
Comprehensive income								921,774
Non- vested restricted stock	14,009	141	22,455	(120,582)				(97,986)
Purchase of treasury stock					(11,777)			(11,777)
Exercise of stock options	4,500	45	150,457					150,502
Balance, March 31, 2008	3,513,155	$ 35,132	$ 26,047,924	$ (273,344)	$ (156,975)	$ 12,039,496	$ 94,282	$ 37,786,515

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Cash flows from operating activities:		
Net income	$ 826,123	$ 707,207
Adjustments to reconcile net income to net cash used by operating activities:		
Provision for loan losses	501,603	135,234
Depreciation and amortization expense	287,706	170,029
Gain on sale of equipment	-	(14,415)
Gain on sale of OREO	-	(9,365)
Gain on sale of available-for-sale securities	-	(1,021)
Discount accretion and premium amortization	7,274	14,806
Deferred income tax benefit	(559,154)	(322,596)
Decrease in interest receivable	115,207	190,223
Decrease in interest payable	(83,510)	(16,351)
Disbursements for loans held for sale	(36,572,893)	(33,444,353)
Proceeds from loans held for sale	37,770,606	31,976,592
Restricted Stock	(97,986)	13,221
Increase in other assets	(172,313)	(418,985)
Increase (decrease) in other liabilities	1,892,946	(78,077)
Net cash provided (used) by operating activities	3,915,609	(1,097,851)
Cash flows from investing activities:		
Purchases of securities available-for-sale	-	(1,410,755)
Sale of securities available-for-sale	-	1,258,870
Net increase in loans receivable	(5,365,863)	(23,506,685)
Maturities of securities available-for-sale	1,087,846	478,138
Sales of other real estate owned	0	516,205
Purchase of non marketable equity securities	(441,800)	(407,300)
Proceeds on sale of nonmarketable equity securities	0	814,500
Proceeds from disposal of premises, furniture, and equipment	0	38,066
Purchases of premises and equipment	(1,636,950)	(1,914,422)
Net cash used by investing activities	(6,356,767)	(24,133,383)
Cash flows from financing activities:		
Net increase (decrease) in demand deposits, interest-bearing transaction accounts and savings accounts	(2,346,309)	6,560,928
Net increase in certificates of deposit and other time deposits	2,859,685	28,813,129
Net increase (decrease) in securities sold under agreements to repurchase	(68,909)	551,310
Increase (decrease) in advances from the Federal Home Loan Bank	4,500,000	(9,500,000)
Proceeds from issuance of shares to ESOP	150,502	143,812
Decrease in Fed Funds Purchased	(1,877,000)	
Sale of treasury stock	(11,777)	-
Proceeds from the exercise of stock options		106,585
Net cash provided by financing activities	3,206,192	26,675,764
Net increase in cash and cash equivalents	765,034	1,444,530
Cash and cash equivalents, beginning	7,164,650	31,463,075
Cash and cash equivalents, end	$ 7,929,684	$ 32,907,605
Cash paid during the period for:		
Income taxes	$ 403,499	$ 12,383
Interest	$ 4,942,178	$ 4,043,782

See notes to condensed consolidated financial statements.

FIRST RELIANCE BANCSHARES, INC.
Notes to Condensed Consolidated Financial Statements

Note 1 - Basis of Presentation

The accompanying financial statements have been prepared in accordance with the requirements for interim financial statements and, accordingly, they are condensed and omit certain disclosures, which would appear in audited annual financial statements. The financial statements as of March 31, 2008 and for the interim periods ended March 31, 2008 and 2007 are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation. The financial information as of December 31, 2007 has been derived from the audited financial statements as of that date. For further information, refer to the financial statements and the notes included in First Reliance Bancshares, Inc.'s 2007 audited financial statements in Form 10-K.

Note 2 - Recently Issued Accounting Pronouncements

The following is a summary of recent authoritative pronouncements:

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," ("SFAS 141(R)") which replaces SFAS 141. SFAS 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS 141(R) is effective for acquisitions by the Company taking place on or after January 1, 2009. Early adoption is prohibited. Accordingly, a calendar year-end company is required to record and disclose business combinations following existing accounting guidance until January 1, 2009. The Company will assess the impact of SFAS 141(R) if and when a future acquisition occurs.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Before this statement, limited guidance existed for reporting noncontrolling interests (minority interest). As a result, diversity in practice exists. In some cases minority interest is reported as a liability and in others it is reported in the mezzanine section between liabilities and equity. Specifically, SFAS 160 requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financials statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interests. SFAS 160 is effective for the Company on January 1, 2009. Earlier adoption is prohibited. The Company is currently evaluating the impact, if any, the adoption of SFAS 160 will have on its financial position, results of operations and cash flows.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"). SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improving the transparency of financial reporting. It is intended to enhance the current disclosure framework in SFAS 133 by requiring that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. This disclosure better conveys the purpose of derivative use in terms of the risks that the entity is intending to manage. SFAS 161 is effective for the Company on January 1, 2009. This pronouncement does not impact accounting measurements but will result in additional disclosures if the Company is involved in material derivative and hedging activities at that time.

In February 2008, the FASB issued FASB Staff Position No. 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions" ("FSP 140-3"). This FSP provides guidance on accounting for a transfer of a financial asset and the transferor's repurchase financing of the asset. This FSP presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS No. 140. However, if certain criteria are met, the initial transfer and repurchase financing are not evaluated as a linked transaction and are evaluated separately under Statement 140. FSP 140-3 will be effective for financial statements issued for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years and earlier application is not permitted. Accordingly, this FSP is effective for the Company on January 1, 2009. The Company is currently evaluating the impact, if any, the adoption of FSP 140-3 will have on its financial position, results of operations and cash flows.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

In April 2008, the FASB issued FASB Staff Position No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets". The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), "Business Combinations," and other U.S. generally accepted accounting principles. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years and early adoption is prohibited. Accordingly, this FSP is effective for the Company on January 1, 2009. The Company does not believe the adoption of FSP 142-3 will have a material impact on its financial position, results of operations or cash flows.

Effective January 1, 2008, the Company adopted SFAS No. 157, "Fair Value Measurements" ("SFAS 157") which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. SFAS 157 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1	Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.
Level 2	Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.
Level 3	Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly-structured or long-term derivative contracts.

The Company has no liabilities carried at fair value or measured at fair value on a nonrecurring basis.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

The Company is predominantly an asset based lender with real estate serving as collateral on a substantial majority of loans. Loans which are deemed to be impaired are primarily valued nonrecurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be level 2 inputs. The aggregate carrying amount of impaired loans at March 31, 2008 was $3,608,197.

FASB Staff Position No. FAS 157-2 delays the implementation of SFAS 157 until the first quarter of 2009 with respect to goodwill, other intangible assets, real estate and other assets acquired through foreclosure and other non-financial assets measured at fair value on a nonrecurring basis.

The Company has no assets or liabilities whose fair values are measured using level 3 inputs.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

Note 3 - Equity Incentive Plan

During the first quarter of 2008, the Company granted no stock appreciation rights. The Company granted 62,481 stock appreciation rights during the same period of 2007. A stock appreciation right entitles an individual to receive the excess of the fair market value from the grant date to the exercise date in a settlement of Company stock. The Company has funded the liability through charges to earnings. The accrued liability for the stock appreciation rights at March 31, 2008 was $120,451.

A summary of the status of the Company's stock appreciation rights as of the three months ended March 31, 2008 is presented below:

	Three months ended March 31, 2008
	Shares
Outstanding at January 1	93,981
Granted	-
Exercised	-
Forfeited	-
Outstanding at March 31, 2008	93,981

During the three months ended March 31, 2008, the Company granted 14,009 shares of restricted stock, pursuant to the 2006 Equity Incentive Plan. The Company granted 4,002 shares of restricted stock during the same period of 2007. The shares "cliff" vest in three years and are fully vested on March 28, 2010. The weighted average fair value of restricted stock granted in three months ended March 31, 2008 was $14.16. Compensation cost associated with the grant was $30,015 for the three months ended March 31, 2008.

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 3 - Equity Incentive Plan, *continued*

A summary of the status of the Company's restricted stock as of the three months ended March 31, 2008 is presented below:

	Three months ended March 31, 2008
	Shares
Outstanding at January 1	16,195
Granted	14,009
Exercised	1,819
Forfeited	-
Outstanding at March 31, 2008	28,385

Note 4 - Stock Compensation Plan

On June 19, 2003, the Company established the 2003 First Reliance Bank Employee Stock Option Plan (Stock Plan) that provides for the granting of options to purchase up to 250,000 shares of the Company's common stock to directors, officers, or employees of the Company. This plan was preceded by the 1999 First Reliance Bank Employee Stock Option Plan, which provided for the granting of options to purchase up to 238,000 shares of the Company's common stock to directors, officers, or employees of the Company. The per-share exercise price of incentive stock options granted under the Stock Plan may not be less than the fair market value of a share on the date of grant. The per-share exercise price of stock options granted is determined by the Board of Directors. The expiration date of any option may not be greater than ten years from the date of grant. Options that expire unexercised or are canceled become available for reissuance. At March 31, 2008, there were no options available for grant under the 2003 plan and no options available for grant under the 1999 plan.

A summary of the status of the Company's stock option plan as of the three months ended March 31, 2008 changes during the period is presented below:

	Three months ended March 31, 2008	
	Shares	Average Exercise Price
Outstanding at January 1	278,847	$ 8.32
Granted	-	
Exercised	4,500	5.00
Forfeited	2,500	11.00
Outstanding at March 31, 2008	271,846	$ 8.35

FIRST RELIANCE BANCSHARES, INC.

Notes to Condensed Consolidated Financial Statements

Note 5 - Earnings Per Share

A reconciliation of the numerators and denominators used to calculate basic and diluted earnings per share for the three month periods ended March 31, 2008 and 2007 are as follows:

	Three Months Ended March 31, 2008		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share			
Income available to common shareholders	$ 826,123	3,494,862	$ 0.24
Effect of dilutive securities			
Stock options		35,533	
Non-vested restricted stock	-	6,466	
Diluted earnings per share			
Income available to common shareholders plus assumed conversions	$ 826,123	3,452,863	$ 0.24

	Three Months Ended March 31, 2007		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic earnings per share			
Income available to common shareholders	$ 707,207	3,432,022	$ 0.21
Effect of dilutive securities			
Stock options		117,374	
Non-vested restricted stock	-	193	
Diluted earnings per share			
Income available to common shareholders plus assumed conversions	$ 707,207	3,549,589	$ 0.20

Note 6 - Comprehensive Income

Comprehensive Income - Accounting principles generally require that recognized income, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	Pre-tax Amount	Tax Benefit	Net-of-tax Amount
For the Quarter Ended March 31, 2008:			
Unrealized gains on securities available-for-sale	$ 144,926	$ 49,275	$ 95,651
Reclassification adjustment for gains (losses) realized in net income	-	-	-
	$ 144,926	$ 49,275	$ 95,651
For the Quarter Ended March 31, 2007:			
Unrealized gains on securities available-for-sale	$ 54,551	$ 18,547	$ 36,004
Reclassification adjustment for gains realized in net income	1,021	347	674
	$ 53,531	$ 18,200	$ 35,330

Note 7 - Reclassifications

Certain captions and amounts in the March 31, 2007 10-Q were reclassified to conform with the March 31, 2008 presentation.