CITIZENS FINANCIAL SERVICES INC
Form 10-Q
November 12, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010
Or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from____________________ to __________________

Commission file number 0-13222

CITIZENS FINANCIAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

PENNSYLVANIA 23-2265045
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

15 South Main Street
Mansfield, Pennsylvania 16933
(Address of principal executive offices)(Zip Code)

Registrant's telephone number, including area code: (570) 662-2121

Indicate by check mark whether the registrant (1) has filed all reports to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes __X__ No_____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes _____ No_____

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ____ Accelerated filer ____

Non-accelerated filer ____ Smaller reporting company __X__
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes____ No __X__

The number of outstanding shares of the Registrant's Common Stock, as of October 28, 2010, was 2,891,697.

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

(in thousands except share data)	September 30 2010	December 31 2009
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	$ 11,392	$ 9,505
Interest-bearing	28,674	21,944
Total cash and cash equivalents	40,066	31,449
Available-for-sale securities	230,493	198,582
Loans (net of allowance for loan losses: 2010, $5,588 and 2009, $4,888)	469,204	451,496
Premises and equipment	12,944	12,227
Accrued interest receivable	3,636	3,141
Goodwill	10,256	10,256
Bank owned life insurance	13,043	12,667
Other assets	9,713	9,659
TOTAL ASSETS	$ 789,355	$ 729,477
LIABILITIES:		
Deposits:		
Noninterest-bearing	$ 68,794	$ 60,061
Interest-bearing	586,446	545,498
Total deposits	655,240	605,559
Borrowed funds	56,454	54,115
Accrued interest payable	1,814	2,037
Other liabilities	6,225	6,239
TOTAL LIABILITIES	719,733	667,950
STOCKHOLDERS' EQUITY:		
Preferred Stock		
$1.00 par value; authorized 3,000,000 shares at September 30, 2010 and none at December 31, 2009; none issued at September 30, 2010 and December 31, 2009	-	-
Common stock		
$1.00 par value; authorized 15,000,000 shares at September 30, 2010 and 10,000,000 at December 31, 2009; issued 3,104,434 shares at September 30, 2010 and 3,076,253 at December 31, 2009	3,104	3,076
Additional paid-in capital	14,219	13,457
Retained earnings	52,968	47,353
Accumulated other comprehensive income	3,984	2,041

Treasury stock, at cost: 212,767 shares at September 30, 2010				
and 204,437 shares at December 31, 2009		(4,653)		(4,400)
TOTAL STOCKHOLDERS' EQUITY		69,622		61,527
TOTAL LIABILITIES AND				
STOCKHOLDERS' EQUITY	$	789,355	$	729,477

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

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CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF INCOME
(UNAUDITED)

(in thousands, except share and per share data)	Three Months Ended September 30 2010	Three Months Ended September 30 2009	Nine Months Ended September 30 2010	Nine Months Ended September 30 2009
INTEREST INCOME:				
Interest and fees on loans	$ 7,782	$ 7,581	$ 23,268	$ 22,616
Interest-bearing deposits with banks	24	15	55	27
Investment securities:				
Taxable	1,178	1,466	3,777	4,647
Nontaxable	772	598	2,140	1,583
Dividends	14	7	27	20
TOTAL INTEREST INCOME	9,770	9,667	29,267	28,893
INTEREST EXPENSE:				
Deposits	2,313	2,777	7,374	8,555
Borrowed funds	444	500	1,324	1,519
TOTAL INTEREST EXPENSE	2,757	3,277	8,698	10,074
NET INTEREST INCOME	7,013	6,390	20,569	18,819
Provision for loan losses	300	400	840	700
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	6,713	5,990	19,729	18,119
NON-INTEREST INCOME:				
Service charges	919	958	2,709	2,664
Trust	130	121	411	397
Brokerage and insurance	91	75	314	228
Gains on loans sold	44	83	92	292
Investment securities gains, net	-	-	99	118
Earnings on bank owned life insurance	127	128	376	364
Other	134	87	358	278
TOTAL NON-INTEREST INCOME	1,445	1,452	4,359	4,341
NON-INTEREST EXPENSES:				
Salaries and employee benefits	2,436	2,393	7,293	7,018
Occupancy	295	272	898	889
Furniture and equipment	114	102	331	336
Professional fees	176	164	509	459
FDIC insurance	245	277	699	1,030
Other	1,220	1,242	3,440	3,581
TOTAL NON-INTEREST EXPENSES	4,486	4,450	13,170	13,313
Income before provision for income taxes	3,672	2,992	10,918	9,147
Provision for income taxes	775	604	2,348	1,941
NET INCOME	$ 2,897	$ 2,388	$ 8,570	$ 7,206
Earnings Per Share	$ 1.00	$ 0.82	$ 2.96	$ 2.48
Cash Dividends Paid Per Share	$ 0.255	$ 0.245	$ 0.760	$ 0.730

Weighted average number of shares outstanding	2,891,875	2,902,147	2,896,314	2,901,701

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

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

(in thousands)	Three Months Ended September 30 2010	Three Months Ended September 30 2009	Nine Months Ended September 30 2010	Nine Months Ended September 30 2009
Net income	$ 2,897	$ 2,388	$ 8,570	$ 7,206
Other comprehensive income:				
Change in unrealized net gains on available for sale securities	1,429	4,385	3,398	5,054
Change in unrealized loss on interest rate swap	(108)	(115)	(355)	123
Less: Reclassification adjustment for gain included in net income	-	-	(99)	(118)
Other comprehensive income before tax	1,321	4,270	2,944	5,059
Income tax expense related to other comprehensive income	449	1,452	1,001	1,720
Other comprehensive income, net of tax	872	2,818	1,943	3,339
Comprehensive income	$ 3,769	$ 5,206	$ 10,513	$ 10,545

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

CITIZENS FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

(in thousands)	Nine Months Ended September 30, 2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 8,570	$ 7,206
Adjustments to reconcile net income to net		
cash provided by operating activities:		
Provision for loan losses	840	700
Depreciation and amortization	362	476
Amortization and accretion of investment securities	561	277
Deferred income taxes	49	155
Investment securities gains, net	(99)	(118)
Realized gains on loans sold	(92)	(292)
Earnings on bank owned life insurance	(376)	(364)
Originations of loans held for sale	(6,607)	(17,546)
Proceeds from sales of loans held for sale	6,699	17,838
(Gain) Loss on sale of foreclosed assets held for sale	(48)	40
Increase in accrued interest receivable	(495)	(632)
Decrease in accrued interest payable	(223)	(159)
Other, net	(748)	95
Net cash provided by operating activities	8,393	7,676
CASH FLOWS FROM INVESTING ACTIVITIES:		
Available-for-sale securities:		
Proceeds from sales of available-for-sale-securities	8,871	6,778
Proceeds from maturity and principal repayments of securities	35,728	35,143
Purchase of securities	(73,674)	(60,548)
Purchase of regulatory stock	-	(586)
Net increase in loans	(19,585)	(16,287)
Purchase of premises and equipment	(1,227)	(1,063)

Proceeds from sale of premises and equipment	-	1,406
Proceeds from sale of foreclosed assets held for sale	665	313
Net cash used in investing activities	(49,222)	(34,844)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in deposits	49,682	33,168
Proceeds from long-term borrowings	3,163	10,545
Repayments of long-term borrowings	(3,324)	(14,050)
Net increase in short-term borrowed funds	2,500	91
Purchase of treasury stock	(381)	(192)
Dividends paid	(2,194)	(2,088)
Net cash provided by financing activities	49,446	27,474
Net increase in cash and cash equivalents	8,617	306
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	31,449	19,856
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 40,066	$ 20,162
Supplemental Disclosures of Cash Flow Information:		
Interest paid	$ 8,921	$ 10,233
Income taxes paid	$ 2,455	$ 2,025
Loans transferred to foreclosed property	$ 1,205	$ 410

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

CITIZENS FINANCIAL SERVICES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation

Citizens Financial Services, Inc., (individually and collectively with its direct and indirect subsidiaries, the "Company") is a Pennsylvania corporation organized as the holding company of its wholly owned subsidiary, First Citizens National Bank (the "Bank"), and the Bank's subsidiary, First Citizens Insurance Agency, Inc. ("First Citizens Insurance").

The accompanying consolidated financial statements have been prepared pursuant to rules and regulations of the Securities and Exchange Commission ("SEC") and in conformity with U.S. generally accepted accounting principles. Because this report is based on an interim period, certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. Certain of the prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no effect on net income or stockholders' equity. All material inter-company balances and transactions have been eliminated in consolidation.

In the opinion of management of the Company, the accompanying interim financial statements for the periods ended September 30, 2010 and 2009 include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial condition and the results of operations for the period. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. The financial performance reported for the Company for the nine-month period ended September 30, 2010 is not necessarily indicative of the results to be expected for the full year. This information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Note 2 - Earnings per Share

The following table sets forth the computation of earnings per share. Earnings per share calculations give retroactive effect to stock dividends declared by the Company. The Company has no dilutive securities.

	Three months ended September 30		Nine months ended September 30	
	2010	2009	2010	2009
Net income applicable to common stock	$2,897,000	$2,388,000	$8,570,000	$7,206,000
Weighted average common shares outstanding	2,891,875	2,902,147	2,896,314	2,901,701
	$1.00	$0.82	$2.96	$2.48

Earnings per
share

Note 3 - Income Tax Expense

Income tax expense is less than the amount calculated using the statutory tax rate, primarily as a result of tax-exempt income earned from state and municipal securities and loans and investments in tax credits.

Note 4 – Investments

The amortized cost and fair value of investment securities at September 30, 2010 and December 31, 2009 were as follows (in thousands):

September 30, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. Agency securities	$ 93,349	$ 1,914	$ (27)	$ 95,236
Obligations of state and political subdivisions	76,484	2,866	(53)	79,297
Corporate obligations	2,998	339	-	3,337
Mortgage-backed securities	48,497	3,059	-	51,556
Equity securities	914	190	(37)	1,067
Total available-for-sale securities	$ 222,242	$ 8,368	$ (117)	$ 230,493

December 31, 2009	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. Agency securities	$ 64,583	$ 888	$ (248)	$ 65,223
Obligations of state and political subdivisions	58,651	1,085	(162)	59,574
Corporate obligations	2,998	168	-	3,166
Mortgage-backed securities	67,026	3,168	-	70,194
Equity securities	371	54	-	425
Total available-for-sale securities	$ 193,629	$ 5,363	$ (410)	$ 198,582

The following table shows the Company’s gross unrealized losses and fair value of the Company’s investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time, that the individual securities have been in a continuous unrealized loss position, at September 30, 2010 and December 31, 2009 (in thousands). As of September 30, 2010 and December 31, 2009, the Company owned 12 and 33 securities whose fair value was less than their cost basis, respectively.

September 30, 2010	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Agency securities	$ 7,053	$ (27)	$ -	$ -	$ 7,053	$ (27)
Obligations of states and political subdivisions	3,858	(51)	100	(2)	3,958	(53)
Total debt securities	10,011	(78)	100	(2)	11,011	(80)
Equity securities	145	(37)	-	-	145	(37)
Total securities	$ 11,056	$ (115)	$ 100	$ (2)	$ 11,156	$ (117)

December 31, 2009	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Agency securities	$ 28,665	$ (248)	$ -	$ -	$ 28,665	$ (248)
Obligations of states and political subdivisions	11,326	(120)	454	(42)	11,780	(162)
Total securities	$ 39,991	$ (368)	$ 454	$ (42)	$ 40,445	$ (410)

As of September 30, 2010, the Company's investment securities portfolio contained unrealized losses on obligations of U.S Agency securities, states and political subdivisions and certain equity securities. For fixed maturity investments management considers whether the present value of cash flows expected to be collected are less than the security's amortized cost basis (the difference defined as the credit loss), the magnitude and duration of the decline, the reasons underlying the decline and the Company's intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value, to determine whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, if the Company does not intend to sell the security, and it is more-likely-than-not that it will not be required to sell the security, before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings. For equity securities where the fair value has been significantly below cost for one year, the Company's policy is to recognize an impairment loss unless sufficient evidence is available that the decline is not other than temporary and a recovery period can be predicted. The Company has concluded that any impairment of its investment securities portfolio outlined in the above table is not other than temporary and is the result of interest rate changes, sector credit rating changes, or company-specific rating changes that are not expected to result in the non-collection of principal and interest during the period.

Proceeds from sales of securities available-for-sale for the nine months ended September 30, 2010 and 2009 were \$8,871,000 and \$6,778,000, respectively. For the three months ended September 30, 2010 and 2009, there were no sales of available-for-sale securities. The gross gains and losses were as follows (in thousands):

	Three Months Ended September 30		Nine months Ended September 30	
	2010	2009	2010	2009
Gross gains	$ -	$ -	$ 99	$ 209

Gross losses	-	-	-	91
Net gains	$ -	$ -	$ 99	$ 118

Investment securities with an approximate carrying value of $153,591,000 and $144,880,000 at September 30, 2010 and December 31, 2009, respectively, were pledged to secure public funds and certain other deposits as provided by law.

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The amortized cost and fair value of debt securities at September 30, 2010, by contractual maturity, are shown below (in thousands):

	Amortized Cost	Fair Value
Available-for-sale securities:		
Due in one year or less	$ 2,747	$ 2,765
Due after one year through five years	63,656	64,666
Due after five years through ten years	31,545	33,080
Due after ten years	123,380	128,915
Total	$ 221,328	$ 229,426

Note 5 – Loans

The Company grants commercial, industrial, agricultural, residential, and consumer loans primarily to customers throughout North Central Pennsylvania and Southern New York. Although the Company believes it had a diversified loan portfolio at September 30, 2010 and December 31, 2009, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within these regions. The major classifications of loans are as follows (in thousands):

	September 30 2010 Amount	December 31, 2009 Amount
Real estate:		
Residential	$ 191,655	$ 194,989
Commercial	145,954	133,953
Agricultural	19,366	19,485
Construction	9,565	5,619
Loans to individuals		
for household, family and other purchases	11,640	11,895
Commercial and other loans	48,820	44,101
State & political subdivision loans	47,792	46,342
Total loans	474,792	456,384
Less allowance for loan losses	5,588	4,888
Net loans	$ 469,204	$ 451,496

The Company had non-accrual loans, inclusive of impaired loans, of $11,820,000 and $5,871,000 at September 30, 2010 and December 31, 2009, respectively. Information with respect to impaired loans as of and for the periods ended September 30, 2010 and December 31, 2009 are as follows (in thousands):

	September 30, 2010	December 31, 2009
Impaired loans without related allowance for loan losses	$ 4,749	$ 4,345
Impaired loans with related allowance for loan losses	6,800	799
Related allowance for loan losses	297	115
Average recorded balance of impaired loans	8,550	2,980

Interest income recognized on impaired loans for the periods ended September 30, 2010 and 2009 was $126,000 and $17,000, respectively.

Changes in the allowance for loan losses were as follows (in thousands):

(in thousands)	Three Months Ended September 30 2010	2009	Nine Months Ended September 30 2010	2009
Balance, at beginning of period	$ 5,302	$ 4,622	$ 4,888	$ 4,378
Provision charged to income	300	400	840	700
Increase related to acquisition			-	-
Recoveries on loans previously charged against the allowance	20	48	144	91
	5,622	5,070	5,872	5,169
Loans charged against the allowance	(34)	(387)	(284)	(486)
Balance, at end of year	$ 5,588	$ 4,683	$ 5,588	$ 4,683

The following is a summary of the past due and non-accrual loans as of September 30, 2010 and December 31, 2009 (in thousands):

	September 30, 2010		
	30 - 90 Days Past Due	90 Days Past Due Accruing	Non-accrual
Real estate:			
Residential	$ 1,245	$ 215	$ 467
Commercial	1,585	1,305	7,523
Agricultural	-	18	2,301
Construction	-	-	-
Loans to individuals for household, family and other purchases	62	3	2
Commercial and other loans	57	19	1,527
State & political	-	-	-

subdivision loans			
Total nonperforming loans	$ 2,956	$ 1,560	$ 11,820

	December 31, 2009		
(in thousands)	30 - 90 Days Past Due	90 Days Past Due Accruing	Non-accrual
Real estate:			
Residential	$ 1,629	$ 75	$ 775
Commercial	1,558	635	1,863
Agricultural	75	-	2,094
Construction	-	-	749
Loans to individuals for household, family and other purchases	88	10	36
Commercial and other loans	610	75	354
State & political subdivision loans	-	89	-
Total nonperforming loans	$ 3,960	$ 884	$ 5,871

Note 6 – Federal Home Loan Bank (FHLB) Stock

Included in Other Assets in the Consolidated Balance Sheet is the Bank's investment in the Federal Home Loan Bank (FHLB) system, of which the Bank is a member. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as a long term investment, impairment is based on ultimate recovery of par value.

As of September 30, 2010 and December 31, 2009, the Bank held $3,682,000 of stock in the FHLB. In December 2008, the FHLB announced that due largely to a decline in the fair value of a segment of its mortgage-backed securities portfolio, it had suspended payment of dividends on the stock and made a decision to no longer purchase "excess stock" from its members. The Bank's stock is not transferrable and can only be redeemed by the FHLB. Further deterioration in the financial condition of the FHLB may lead management to a conclusion that the cost of the Bank's stock in the FHLB is not recoverable, which would result in a charge to earnings for impairment of the Bank's holdings of the stock. As of September 30, 2010 and December 31, 2009, the investment in the FHLB is not deemed other-than-temporarily impaired based upon management's determination of the recoverability of par value.

Note 7 - Employee Benefit Plans

For a detailed disclosure on the Company's pension and employee benefits plans, please refer to Note 10 of the Company's Consolidated Financial Statements included in the 2009 Annual Report on Form 10-K.

Noncontributory Defined Benefit Pension Plan

The Bank sponsors a noncontributory defined benefit pension plan ("Pension Plan") covering substantially all employees and officers. The Bank's funding policy is to make annual contributions, if needed, based upon the funding formula developed by the plan's actuary.

The Pension Plan was amended, effective January 1, 2008, to cease eligibility for employees with a hire date of January 1, 2008 or later. In lieu of the Pension Plan, employees with a hire date of January 1, 2008 or later are eligible to receive, after meeting certain length of service requirements, an annual discretionary 401(k) plan contribution from the Bank equal to a percentage of an employee's base compensation. The contribution amount, if any, is placed in a separate account within the 401(k) plan and is subject to a vesting requirement.

The Pension Plan was also amended, effective January 1, 2008, for employees who are still eligible to participate. The amended Pension Plan requires benefits to be paid to eligible employees based primarily upon age and compensation rates during employment. Upon retirement or other termination of employment, employees can elect either an annuity benefit or a lump sum distribution of vested benefits in the Pension Plan.

The following sets forth the components of net periodic benefit costs of the Pension Plan for the three and nine months ended September 30, 2010 and 2009, respectively (in thousands):

	Three Months Ended September 30		Nine Months Ended September 30	
	2010	2009	2010	2009
Service cost	$ 45	$ 90	$ 259	$ 240
Interest cost	59	116	340	309
Expected return on plan assets	(77)	(113)	(446)	(302)
Net amortization and deferral	6	37	37	99
Net periodic benefit cost	$ 33	$ 130	$ 191	$ 346

The Company expects to contribute, and has contributed, $450,000 to the Pension Plan in 2010.

Defined Contribution Plan

The Company sponsors a voluntary 401(k) savings plan which eligible employees can elect to contribute up to the maximum amount allowable not to exceed the limits of IRS Code Sections 401(k). Under the plan, the Company also makes required contributions on behalf of the eligible employees. The Company's contributions vest immediately. Contributions by the Company totaled $171,000 and $159,000 for the nine months ended September 30, 2010 and 2009, respectively.

Directors' Deferred Compensation Plan

The Company's directors may elect to defer all or portions of their fees until their retirement or termination from service. Amounts deferred under the plan earn interest based upon the highest current rate offered to certificate of deposit customers. Amounts deferred under the plan are not guaranteed and represent a general liability of the Company. Amounts included in interest expense on the deferred amounts totaled $22,000 and $28,000 for the nine months ended September 30, 2010 and 2009, respectively.

Restricted Stock Plan

Effective April 18, 2006, shareholders of the Company approved the 2006 Restricted Stock Plan (the "Plan"). Employees and non-employee corporate directors are eligible to receive awards of restricted stock based upon performance related requirements. Awards granted under the Plan are in the form of the Company's common stock and are subject to certain vesting requirements including continuous employment or service with the Company. 100,000 shares of the Company's common stock have been authorized under the Plan, which terminates April 18, 2016. The Plan assists the Company in attracting, retaining and motivating employees to make substantial contributions to the success of the Company and to increase the emphasis on the use of equity as a key component of compensation.

For the nine months ended September 30, 2010 and 2009, 5,090 and 7,526 shares of restricted stock were awarded and 4,948 and 2,517 shares were vested, respectively. Compensation cost related to restricted stock is recognized based on the market price of the stock at the grant date over the vesting period. Compensation expense related to restricted stock was $94,000 and $72,000 for the nine months ended September 30, 2010 and 2009, respectively.

Supplemental Executive Retirement Plan

During 2008, the Company adopted a non-qualified supplemental executive retirement plan ("SERP") for certain executives to compensate those executive participants in the Company's noncontributory defined benefit pension plan whose benefits are limited by compensation limitations under current tax law. At September 30, 2010 and December 31, 2009, an obligation of $647,000 and $399,000, respectively, was included in other liabilities for this plan in the consolidated balance sheet. Expenses related to this plan totaled $248,000 and $158,000 for the nine months ended September 30, 2010 and 2009.

Note 8 – Fair Value Measurements

Fair value disclosures establish a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by this hierarchy are as follows:

Level I:	Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
Level II:	Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.
Level III:	Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

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The following tables present the assets reported on the consolidated statements of financial condition at their fair value as of September 30, 2010 and December 31, 2009 by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

(In thousands)	September 30, 2010			
	Level 1	Level II	Level III	Total
Fair value measurements on a recurring basis:				
Securities available for sale:				
U.S. Agency securities	$ -	$ 95,236	$ -	$ 95,236
Obligations of state and political subdivisions	-	79,297	-	79,297
Corporate obligations	-	3,337	-	3,337
Mortgage-backed securities	-	51,556	-	51,556
Equity securities	1,067	-	-	1,067
Trust Preferred Interest Rate Swap	-	(520)	-	(520)
Fair value measurements on non-recurring basis:				
Impaired Loans	-	1,728	9,524	11,252
Other real estate owned	-	739	-	739

(In thousands)	December 31, 2009			
	Level 1	Level II	Level III	Total
Fair value measurements on a recurring basis:				
Securities available for sale:				
U.S. Agency securities	$ -	$ 65,223	$ -	$ 65,223
Obligations of state and political subdivisions	-	59,574	-	59,574

Corporate obligations	-	3,166	-	3,166
Mortgage-backed securities	-	70,194	-	70,194
Equity securities	425	-	-	425
Trust Preferred Interest Rate Swap	-	(166)	-	(166)
Fair value measurements on non-recurring basis:				
Impaired Loans	-	5,029	-	5,029
Other real estate owned	-	101	-	101

The fair values of the Company's financial instruments are as follows (in thousands):

	September 30 2010		December 31 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	$ 40,066	$ 40,066	$ 31,449	$ 31,449
Available-for-sale securities	230,493	230,493	198,582	198,582
Net loans	469,204	490,620	451,496	466,967
Bank owned life insurance	13,043	13,043	12,667	12,667
Regulatory stock	3,957	3,957	3,957	3,957
Accrued interest receivable	3,636	3,636	3,141	3,141
Financial liabilities:				
Deposits	$ 655,240	$ 664,525	$ 605,559	$ 611,705
Borrowed funds	56,454	54,955	54,115	50,582
Trust preferred interest rate swap	520	520	166	166
Accrued interest payable	1,814	1,814	2,037	2,037

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's 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. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions can significantly affect the estimates.

Fair values have been determined by the Company using historical data, as generally provided in the Company's regulatory reports, and an estimation methodology suitable for each category of financial instruments. The Company's fair value estimates, methods and assumptions are set forth below for the Company's other financial instruments.

Cash and Cash Equivalents:

The carrying amounts for cash and due from banks approximate fair value because they have original maturities of 90 days or less and do not present unanticipated credit concerns.

Accrued Interest Receivable and Payable:

The carrying amounts for accrued interest receivable and payable approximate fair value because they are generally received or paid in 90 days or less and do not present unanticipated credit concerns.

Available-For-Sale Securities:

The fair values of available-for-sale securities are based on quoted market prices as of the balance sheet date. For certain instruments, fair value is estimated by obtaining quotes from independent dealers.

Loans:

Fair values are estimated for portfolios of loans with similar financial characteristics. The fair value of performing loans has been estimated by discounting expected future cash flows. The discount rate used in these calculations is derived from the Treasury yield curve adjusted for credit quality, operating expense and prepayment option price, and is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Company’s historical experience with repayments for each loan classification, modified as required by an estimate of the effect of current economic and lending conditions.

Fair value for significant nonperforming loans is based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information.

Bank Owned Life Insurance:

The carrying value of bank owned life insurance approximates fair value based on applicable redemption provisions.

Regulatory Stock:

The carrying value of regulatory stock approximates fair value based on applicable redemption provisions.

Deposits:

The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings and NOW accounts, and money market accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

The deposits’ fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market, commonly referred to as the core deposit intangible.

Borrowed Funds:

Rates available to the Company for borrowed funds with similar terms and remaining maturities are used to estimate the fair value of borrowed funds.

Trust Preferred Interest Rate Swap:

The fair value of the trust preferred interest rate swap is based on a pricing model that utilizes a yield curve and information contained in the swap agreement.

Note 9 – Recent Accounting Pronouncements

In December 2009, the FASB issued ASU 2009-16, Accounting for Transfer of Financial Assets. ASU 2009-16 provides guidance to improve the relevance, representational faithfulness, and comparability of the information that an entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. ASU 2009-16 is effective for annual periods beginning after November 15, 2009 and for interim periods within those fiscal years. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In January 2010, the FASB issued ASU 2010-01, Equity (Topic 505): Accounting for Distributions to Shareholders with Components of Stock and Cash – a consensus of the FASB Emerging Issues Task Force. ASU 2010-01 clarifies that the stock portion of a distribution to shareholders that allows them to elect to receive cash or stock with a potential limitation on the total amount of cash that all shareholders can elect to receive in the aggregate is considered a share issuance that is reflected in EPS prospectively and is not a stock dividend. ASU 2010-01 is effective for interim and annual periods ending on or after December 15, 2009 and should be applied on a retrospective basis. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of this guidance is not expected to have a significant impact on the Company's financial statements.

In February 2010, the FASB issued ASU 2010-08, Technical Corrections to Various Topics. ASU 2010-08 clarifies guidance on embedded derivatives and hedging. ASU 2010-08 is effective for interim and annual periods beginning after December 15, 2009. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In March 2010, the FASB issued ASU 2010-11, Derivatives and Hedging. ASU 2010-11 provides clarification and related additional examples to improve financial reporting by resolving potential ambiguity about the breadth of the embedded credit derivative scope exception in ASC 815-15-15-8. ASU 2010-11 is effective at the beginning of the first fiscal quarter beginning after September 15, 2010. The Company is currently evaluating the impact the adoption of this standard will have on the Company's financial position or results of operation.

In April 2010, the FASB issued ASU 2010-18, Receivables (Topic 310): Effect of a Loan Modification When the Loan is a Part of a Pool That is Accounted for as a Single Asset – a consensus of the FASB Emerging Issues Task Force. ASU 2010-18 clarifies the treatment for a modified loan that was acquired as part of a pool of assets. Refinancing or restructuring the loan does not make it eligible for removal from the pool, the FASB said. The amendment will be effective for loans that are part of an asset pool and are modified during financial reporting periods that end July 15, 2010 or later is not expected to have a significant impact on the Company's financial statements

In July 2010, FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. ASU 2010-20 is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The amendments in ASU 2010-20 encourage, but do not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption. The Company is currently evaluating the impact the adoption of this guidance will have on the Company's financial position or results of operations.

In August, 2010, the FASB issued ASU 2010-21, Accounting for Technical Amendments to Various SEC Rules and Schedules. This ASU amends various SEC paragraphs pursuant to the issuance of Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules, and Codification of Financial Reporting Policies and is not expected to have a significant impact on the Company’s financial statements.

In August, 2010, the FASB issued ASU 2010-22, Technical Corrections to SEC Paragraphs – An announcement made by the staff of the U.S. Securities and Exchange Commission. This ASU amends various SEC paragraphs based on external comments received and the issuance of SAB 112, which amends or rescinds portions of certain SAB topics and is not expected to have a significant impact on the Company's financial statements.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

We have made forward-looking statements in this document, and in documents that we incorporate by reference, that are subject to risks and uncertainties. Forward-looking statements include information concerning possible or assumed future results of operations of Citizens Financial Services, Inc., First Citizens National Bank, First Citizens Insurance Agency, Inc. or the combined Company. When we use words such as "believes," "expects," "anticipates," or similar expressions, we are making forward-looking statements. For a variety of reasons, actual results could differ materially from those contained in or implied by forward-looking statements. The Company would like to caution readers that the following important factors, among others, may have affected and could in the future affect the Company's actual results and could cause the Company's actual results for subsequent periods to differ materially from those expressed in any forward-looking statement:

- Interest rates could change more rapidly or more significantly than we expect.
- The economy could change significantly in an unexpected way, which would cause the demand for new loans and the ability of borrowers to repay outstanding loans to change in ways that our models do not anticipate.
- The stock and bond markets could suffer a significant disruption, which may have a negative effect on our financial condition and that of our borrowers, and on our ability to raise money by issuing new securities.
- It could take us longer than we anticipate implementing strategic initiatives designed to increase revenues or manage expenses, or we may not be able to implement those initiatives at all.
- Acquisitions and dispositions of assets could affect us in ways that management has not anticipated.
- We may become subject to new legal obligations or the resolution of litigation may have a negative effect on our financial condition.
- We may become subject to new and unanticipated accounting, tax, or regulatory practices, regulations or requirements, including the costs of compliance with such changes.
- We could experience greater loan delinquencies than anticipated, adversely affecting our earnings and financial condition. We could also experience greater losses than expected due to the ever increasing volume of information theft and fraudulent scams impacting our customers and the banking industry.
- We could lose the services of some or all of our key personnel, which would negatively impact our business because of their business development skills, financial expertise, lending experience, technical expertise and market area knowledge.
- Exploration and drilling of the natural gas reserves in the Marcellus Shale in our market area may be affected by federal, state and local laws and regulations such as restrictions on production, permitting, changes in taxes and environmental protection, which could negatively impact our customers and, as a result, negatively impact our loan and deposit volume and loan quality.

Additional factors that may affect our results are discussed under "Part II – Item 1A – Risk Factors" in this report and in the Company's Annual Report on Form 10-K under "Item 1.A/ Risk Factors." Except as required by applicable law and regulation, we assume no obligation to update or revise any forward-looking statements after the date on which they are made.

Introduction

The following is management's discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in its accompanying consolidated financial statements for the Company. Our Company's consolidated financial condition and results of operations consist almost entirely of the Bank's financial condition and results of operations. Management's discussion and analysis should be read in conjunction with the preceding financial statements presented under Part I. The results of operations for the three months and nine months ended September 30, 2010 are not necessarily indicative of the results you may expect for the full year.

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Our Company currently engages in the general business of banking throughout our service area of Potter, Tioga and Bradford counties in North Central Pennsylvania and Allegany, Steuben, Chemung and Tioga counties in Southern New York. We maintain our main office in Mansfield, Pennsylvania. Presently we operate 17 banking facilities. In Pennsylvania, these offices are located in Mansfield, Blossburg, Ulysses, Genesee, Wellsboro, Troy, Sayre, Canton, Gillett, Millerton, LeRaysville, Towanda, the Wellsboro Weis Market store, and the Mansfield Wal-Mart Super Center. In New York, we have a branch office in Wellsville, Allegany County.

Risk Management

Risk identification and management are essential elements for the successful management of the Company. In the normal course of business, the Company is subject to various types of risk, including interest rate, credit, liquidity, reputational and regulatory risk.

Interest rate risk is the sensitivity of net interest income and the market value of financial instruments to the direction and frequency of changes in interest rates. Interest rate risk results from various re-pricing frequencies and the maturity structure of the financial instruments owned by the Company. The Company uses its asset/liability and funds management policy to control and manage interest rate risk.

Credit risk represents the possibility that a customer may not perform in accordance with contractual terms. Credit risk results from loans with customers and the purchasing of securities. The Company's primary credit risk is in the loan portfolio. The Company manages credit risk by adhering to an established credit policy and through a disciplined evaluation of the adequacy of the allowance for loan losses. Also, the investment policy limits the amount of credit risk that may be taken in the investment portfolio.

Liquidity risk represents the inability to generate or otherwise obtain funds at reasonable rates to satisfy commitments to borrowers and obligations to depositors. The Company has established guidelines within its asset/liability and funds management policy to manage liquidity risk. These guidelines include, among other things, contingent funding alternatives.

Reputational risk, or the risk to our business, earnings, liquidity, and capital from negative public opinion, could result from our actual or alleged conduct in a variety of areas, including legal and regulatory compliance, lending practices, corporate governance, litigation, ethical issues, or inadequate protection of customer information. We expend significant resources to comply with regulatory requirements. Failure to comply could result in reputational harm or significant legal or remedial costs. Damage to our reputation could adversely affect our ability to retain and attract new customers, and adversely impact our earnings and liquidity.

Regulatory risk represents the possibility that a change in law, regulations or regulatory policy may have a material effect on the business of the Company and its subsidiary. We cannot predict what legislation might be enacted or what regulations might be adopted, or if adopted, the effect thereof on our operations.

Competition

We face strong competition in the communities that we serve from other commercial banks, savings banks, and savings and loan associations, some of which are substantially larger institutions than the Bank. In addition, insurance companies, investment-counseling firms, and other business firms and individuals offer personal and corporate trust services. We also compete with credit unions, issuers of money market funds, securities brokerage firms, consumer finance companies, mortgage brokers and insurance companies. These entities are strong competitors for virtually all types of financial services. The financial services industry continues to experience tremendous change to competitive barriers between bank and non-bank institutions. We must compete not only with traditional financial institutions, but also other business corporations that have begun to deliver competing financial services and banking services that are easily accessible through the internet. Competition for banking services is primarily based on price, nature of product, quality of service, and convenience of location.

Trust and Investment Services

Our Investment and Trust Services Department offers professional trust administration, investment management services, estate planning and administration, and custody of securities. Assets held by the Company in a fiduciary or agency capacity for its customers are not included in the consolidated financial statements since such items are not assets of the Company. Revenues and fees of the Trust Department are reflected in the Company's financial statements. As of September 30, 2010 and December 31, 2009, the Trust Department had $91.0 and $85.9 million of assets under management, respectively. The $5.1 million increase is primarily attributable to net additions of $3.4 million with the remaining increase the result of fluctuations in the stock market.

Our Investment Representatives offer full service brokerage services and financial planning throughout the Bank's market area. Products such as mutual funds, annuities, health and life insurance are made available through our insurance subsidiary, First Citizens Insurance. The assets associated with these products are not included in the consolidated financial statements since such items are not assets of the Company. Assets owned and invested by customers of the Bank through the Bank's Investment Representatives increased from $48.6 million at December 31, 2009 to $66.2 million at September 30, 2010. Fee income from the sale of these products is reflected in the Company's financial statements as a component of non-interest income in the Consolidated Statement of Income.

Results of Operations

Overview of the Income Statement

The Company had net income of $8,570,000 for the first nine months of 2010 compared to earnings of $7,206,000 for last year's comparable period, an increase of $1,364,000 or 18.9%. Earnings per share for the first nine months of 2010 were $2.96, compared to $2.48 last year, representing a 19.4% increase. Annualized return on assets and return on equity for the nine months of 2010 were 1.51% and 18.31%, respectively, compared with 1.39% and 17.46% for last year's comparable period.

Net income for the three months ended September 30, 2010 was $2,897,000 compared to earnings of $2,388,000 in the comparable 2009 period, an increase of $509,000. Earnings per share for the three months ended September 30, 2010 and 2009 were $1.00 and $0.82 per share, respectively. Annualized return on assets and return on equity for the quarter ended September 30, 2010 was 1.49% and 17.98%, respectively, compared with 1.35% and 16.84% for the same 2009 period.

Net Interest Income

Net interest income, the most significant component of the Company's earnings, is the amount by which interest income generated from interest-earning assets exceeds interest expense on interest-bearing liabilities.

Net interest income for the first nine months of 2010 was $20,569,000, an increase of $1,750,000, or 9.3%, compared to the same period in 2009. For the first nine months of 2010, the provision for loan losses totaled $840,000, an increase of $140,000 over the comparable period in 2009. Consequently, net interest income after the provision for loan losses was $19,729,000 compared to $18,119,000 during the first nine months of 2009.

For the three months ended September 30, 2010, net interest income was $7,013,000 compared to $6,390,000, an increase of $623,000, or 9.8% over the comparable period in 2009. The provision for loan losses this quarter was $300,000 compared to $400,000 for last year's third quarter. Consequently, net interest income after the provision for loan losses was $6,713,000 for the quarter ended compared to $5,990,000 in 2009.

The following table sets forth the average balances of, and the interest earned or incurred on, for each principal category of assets, liabilities and stockholders' equity, the related rates, net interest income and rate "spread" created for the nine months and three months ended September 30, 2010 and 2009 on a tax equivalent basis:

Analysis of Average Balances and Interest Rates (1)
Nine Months Ended

	September 30, 2010			September 30, 2009		
	Average Balance (1)	Interest	Average Rate	Average Balance (1)	Interest	Average Rate
(dollars in thousands)	$	$	%	$	$	%
ASSETS						
Short-term investments:						
Interest-bearing deposits at banks	25,555	55	0.29	19,894	27	0.18
Total short-term investments	25,555	55	0.29	19,894	27	0.18
Investment securities:						
Taxable	145,917	3,804	3.48	131,218	4,667	4.74
Tax-exempt (3)	67,474	3,243	6.41	49,726	2,399	6.43
Total investment securities	213,391	7,047	4.40	180,944	7,066	5.21
Loans:						
Residential mortgage loans	202,500	10,746	7.09	204,144	11,112	7.28
Commercial & farm loans	206,158	10,345	6.71	178,301	9,284	6.96
Loans to state & political subdivisions	46,810	2,069	5.91	46,439	2,144	6.17
Other loans	11,526	751	8.71	11,436	761	8.89
Loans, net of discount (2)(3)(4)	466,994	23,911	6.85	440,320	23,301	7.08
Total interest-earning assets	705,940	31,013	5.87	641,158	30,394	6.34
Cash and due from banks	9,450			9,476		
Bank premises and equipment	12,577			11,813		
Other assets	28,917			27,496		
Total non-interest earning assets	50,944			48,785		
Total assets	756,884			689,943		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
NOW accounts	149,503	794	0.71	120,999	732	0.81
Savings accounts	53,519	120	0.30	46,216	110	0.32
Money market accounts	45,151	189	0.56	41,513	262	0.84
Certificates of deposit	322,036	6,271	2.60	302,617	7,451	3.29
Total interest-bearing deposits	570,209	7,374	1.73	511,345	8,555	2.24
Other borrowed funds	53,281	1,324	3.32	58,175	1,519	3.49
Total interest-bearing liabilities	623,490	8,698	1.87	569,520	10,074	2.36

Demand deposits	63,366		56,564	
Other liabilities	7,641		8,830	
Total non-interest-bearing liabilities	71,007		65,394	
Stockholders' equity	62,387		55,029	
Total liabilities & stockholders' equity	756,884		689,943	
Net interest income		22,315		20,320
Net interest spread (5)		4.00%		3.97%
Net interest income as a percentage of average interest-earning assets		4.23%		4.24%
Ratio of interest-earning assets to interest-bearing liabilities		1.13		1.13

(1) Averages are based on daily averages.
(2) Includes loan origination and commitment fees.
(3) Tax exempt interest revenue is shown on a tax equivalent basis for proper comparison using a statutory federal income tax rate of 34%.
(4) Income on non-accrual loans is accounted for on a cash basis, and the loan balances are included in interest-earning assets.
(5) Interest rate spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities.

Analysis of Average Balances and Interest Rates (1)
Three Months Ended

	September 30, 2010			September 30, 2009		
(dollars in thousands)	Average Balance (1) $	Interest $	Average Rate %	Average Balance (1) $	Interest $	Average Rate %
ASSETS						
Short-term investments:						
Interest-bearing deposits at banks	32,773	24	0.29	22,956	15	0.27
Total short-term investments	32,773	24	0.29	22,956	15	0.27
Investment securities:						
Taxable	145,997	1,192	3.26	135,243	1,473	4.36
Tax-exempt (3)	73,402	1,170	6.38	55,926	905	6.47
Total investment securities	219,399	2,362	4.30	191,169	2,378	4.98
Loans:						
Residential mortgage loans	204,473	3,636	7.05	201,992	3,649	7.17
Commercial & farm loans	209,849	3,411	6.45	185,403	3,191	6.83
Loans to state & political subdivisions	47,126	694	5.85	46,472	706	6.03
Other loans	11,503	250	8.62	11,751	260	8.74
Loans, net of discount (2)(3)(4)	472,951	7,991	6.70	445,618	7,806	6.95
Total interest-earning assets	725,123	10,377	5.68	659,743	10,199	6.13
Cash and due from banks	9,726			9,067		
Bank premises and equipment	12,924			11,896		
Other assets	29,139			27,533		
Total non-interest earning assets	51,789			48,496		
Total assets	776,912			708,239		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
NOW accounts	158,926	212	0.53	123,265	234	0.75
Savings accounts	56,496	43	0.30	47,609	37	0.31
Money market accounts	49,339	67	0.54	41,996	78	0.74
Certificates of deposit	318,824	1,991	2.48	312,898	2,428	3.08
Total interest-bearing deposits	583,585	2,313	1.57	525,768	2,777	2.09
Other borrowed funds	53,553	444	3.29	58,959	500	3.37
Total interest-bearing liabilities	637,138	2,757	1.72	584,727	3,277	2.22

Demand deposits	67,630			58,080		
Other liabilities	7,716			8,697		
Total non-interest-bearing liabilities	75,346			66,777		
Stockholders' equity	64,428			56,735		
Total liabilities & stockholders' equity	776,912			708,239		
Net interest income		7,620			6,922	
Net interest spread (5)			3.96%			3.91%
Net interest income as a percentage						
of average interest-earning assets			4.17%			4.16%
Ratio of interest-earning assets						
to interest-bearing liabilities			1.14			1.13

(1) Averages are based on daily averages.
(2) Includes loan origination and commitment fees.
(3) Tax exempt interest revenue is shown on a tax equivalent basis for proper comparison using a statutory federal income tax rate of 34%.
(4) Income on non-accrual loans is accounted for on a cash basis, and the loan balances are included in interest-earning assets.
(5) Interest rate spread represents the difference between the average rate earned on interest-earning assets
and the average rate paid on interest-bearing liabilities.

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Tax exempt revenue is shown on a tax-equivalent basis for proper comparison using a statutory, federal income tax rate of 34%. For purposes of the comparison, as well as the discussion that follows, this presentation facilitates performance comparisons between taxable and tax-free assets by increasing the tax-free income by an amount equivalent to the Federal income taxes that would have been paid if this income were taxable at the Company's 34% Federal statutory rate. The following table represents the adjustment to convert net interest income to net interest income on a fully taxable equivalent basis for the periods ending September 30, 2010 and 2009:

(dollars in thousands)	For the Three Months Ended September 30 2010	2009	For the Nine Months Ended September 30 2010	2009
Interest and dividend income from investment securities and interest bearing deposits at banks (non-tax adjusted)	$ 1,988	$ 2,086	$ 5,999	$ 6,277
Tax equivalent adjustment	398	307	1,103	816
Interest and dividend income from investment securities and interest bearing deposits at banks (tax equivalent basis)	$ 2,386	$ 2,393	$ 7,102	$ 7,093
Interest and fees on loans (non-tax adjusted)	$ 7,782	$ 7,581	$ 23,268	$ 22,616
Tax equivalent adjustment	209	225	643	685
Interest and fees on loans (tax equivalent basis)	$ 7,991	$ 7,806	$ 23,911	$ 23,301
Total interest income	$ 9,770	$ 9,667	$ 29,267	$ 28,893
Total interest expense	2,757	3,277	8,698	10,074
Net interest income	7,013	6,390	20,569	18,819
Total tax equivalent adjustment	607	532	1,746	1,501
Net interest income (tax equivalent basis)	$ 7,620	$ 6,922	$ 22,315	$ 20,320

The following table shows the tax-equivalent effect of changes in volume and rate on interest income and expense.

Analysis of Changes in Net Interest Income on a Tax-Equivalent Basis (1)

(in thousands)	Three months ended September 30, 2010 vs. 2009 (1) Change in Volume	Change in Rate	Total Change	Nine months ended September 30, 2010 vs. 2009 (1) Change in Volume	Change in Rate	Total Change
Interest Income:						
Short-term investments:						
Interest-bearing deposits at banks	$ 8	$ 1	$ 9	$ 8	$ 20	$ 28
Investment securities:						
Taxable	110	(391)	(281)	623	(1,486)	(863)
Tax-exempt	279	(14)	265	853	(9)	844
Total investments	389	(405)	(16)	1,476	(1,495)	(19)
Loans:						
Residential mortgage loans	45	(58)	(13)	(89)	(277)	(366)
Commercial & farm loans	404	(184)	220	1,382	(321)	1,061
Loans to state & political subdivisions	10	(22)	(12)	17	(92)	(75)
Other loans	(5)	(5)	(10)	5	(15)	(10)
Total loans, net of discount	454	(269)	185	1,315	(705)	610
Total Interest Income	851	(673)	178	2,799	(2,180)	619
Interest Expense:						
Interest-bearing deposits:						
NOW accounts	58	(80)	(22)	129	(67)	62
Savings accounts	7	(1)	6	16	(6)	10
Money Market accounts	12	(23)	(11)	25	(98)	(73)
Certificates of deposit	45	(482)	(437)	523	(1,703)	(1,180)
Total interest-bearing deposits	122	(585)	(463)	693	(1,874)	(1,181)
Other borrowed funds	(45)	(11)	(56)	(124)	(71)	(195)
	77	(597)	(520)	569	(1,945)	(1,376)

Total interest expense						
Net interest income	$ 774	$ (76)	$ 698	$ 2,230	$ (235)	$ 1,995

(1) The portion of the total change attributable to both volume and rate changes, which can not be separated, has been allocated proportionally to the change due to volume and the change due to rate prior to allocation.

Tax equivalent net interest income increased from $20,320,000 for the 2009 nine month period to $22,315,000 in the 2010 nine month period, an increase of $1,995,000 for the nine months ended September 30, 2010. The tax equivalent net interest margin decreased slightly from 4.24% for the first nine months of 2009 to 4.23% in 2010.

Total tax equivalent interest income for the nine month period increased $619,000. This increase is primarily a result of a $2,799,000 increase due to volume as the average balance of interest earning assets increased by $65.4 million. There was a decrease of $2,180,000 due to change in rate, as the yield on interest earning assets decreased 47 basis points from 6.34% to 5.87%.

Tax equivalent investment income for the nine months ended September 30, 2010 decreased $19,000 over the same period last year. The average balance of total investment securities at September 30, 2010 increased by $32.4 million from September 30, 2009 as a result of investing excess cash from increased deposits.

- The average balance of taxable securities increased by $14.7 million while tax-exempt securities increased by $17.7 million, which had the effect of increasing interest income by $623,000 and $853,000, respectively, due to volume.

- This increase was offset by a decrease in the yield on investment securities of 81 basis points from 5.21% to 4.40%, which corresponds to a decrease in interest income of $1,495,000. The majority of this decrease is attributable to the change in yield on taxable securities, which experienced a decrease of 126 basis points from 4.74% to 3.48%. The yield on investments has declined due to the amount of purchases we have made in the current low interest rate environment as a result of our increased deposits and investment cash flows. As a result of this environment our strategy has been to invest in short-term agency bonds and longer-term municipal bonds (See also "Financial Condition – Investments").

The purchase of tax-exempt securities, along with municipal loans, allows us to manage our effective tax rate as well as the overall yield on our interest earning assets.

Total loan interest income increased $610,000 for the nine months ended September 30, 2010 compared to the same period last year.

- Interest income on residential mortgage loans decreased $366,000 of which $89,000 was due to volume and $277,000 was due to a decrease in rate. The average balance decreased $1.6 million due to the continuing recessionary pressures within the economy, high unemployment rates and other negative economic factors that resulted in lower loan demand for non-conforming residential mortgages and home equity lines. Management also believes that a portion of the decreased loan demand for home equity loans is the result of customers receiving monies related to exploration and drilling of the natural gas reserves in the Marcellus Shale in our market area. As a result, customers may be less reliant on home equity loans.

- The average balance of commercial and farm loans increased $27.9 million from a year ago primarily due to our emphasis to grow this segment of the loan portfolio utilizing disciplined underwriting standards. This had a positive impact of $1,382,000 on total interest income due to volume, which was offset by a reduction due to a decrease in rate of $321,000.

Total interest expense decreased $1,376,000 for the nine months ended September 30, 2010 compared with last year. This decrease is primarily due to a change in rate, accounting for a $1,945,000 decrease in our interest expense. The average interest rate on interest-bearing liabilities decreased 49 basis points, from 2.36% to 1.87%. The historically low interest rates supported by the Federal Reserve and continuing recessionary pressures within the economy had the effect of decreasing our short-term borrowing costs as well as rates on deposit products, including certificates of deposit and rate sensitive NOW and money market accounts. Offsetting this, the average balance of interest-bearing liabilities increased $54.0 million resulting in an increase in interest expense of $569,000 (see also "Financial Condition – Deposits").

- Interest expense on certificates of deposits decreased $1,180,000 over the same period last year. The average balance of certificates of deposit increased $19.4 million causing an increase in interest expense of $523,000. Offsetting this was a decrease in the average rate on certificates of deposit from 3.29% to 2.60% resulting in a decrease in interest expense of $1,703,000.

- The average balance of NOW accounts also increased $28.5 million accounting for an increase of $129,000 in interest expense. The change in the average rate from 81 basis points to 71 basis points, contributed to a decrease in interest expense of $67,000 resulting in an overall increase of $62,000.

- The average balance of borrowed funds decreased by $4.9 million resulting in a decrease in interest expense of $124,000. The average interest rate paid on borrowed funds also decreased by 17 basis points accounting for a decrease in interest expense of $71,000 due to rate. Borrowed funds decreased due to the significant increase in deposits, which continued to limit our need for borrowings from the Federal Home Loan Bank.

Tax equivalent net interest income for the three months ended September 30, 2010 was $7,620,000 which compares to $6,922,000 for the same period last year. This represents an increase of $698,000 or 10.0%. Total tax equivalent interest income was $10,377,000 compared with $10,199,000 for the comparable period last year, an increase of $178,000:

- Of this amount, $851,000 was due to an increase in volume as a result of a $65.4 million increase in interest earning assets. This was offset by a decrease of $673,000, which was a result of a decrease of 45 basis points on our yield on interest earning assets.

- Total investment income decreased by $16,000 compared to last year. This was predominantly due to a 68 point decrease in rate on investments from 4.98% to 4.30% offset by an increase in average investment securities of $28.2 million.

- Total loan interest income increased $185,000 compared to last year. This was predominantly due to a change in volume as a result of $27.3 million increase in average loans outstanding offset by a decrease of 25 points in rate from 6.95% to 6.70%.

Total interest expense decreased $520,000 for the three months ended September 30, 2010 compared with last year. $77,000 is attributable to an increase in volume mostly due to a $5.9 million increase in certificates of deposit. Conversely, $597,000 is due to a decrease in rate as the average rate on interest-bearing liabilities decreased 50 basis points from 2.22% to 1.72%.

Provision For Loan Losses

For the nine month period ending September 30, 2010, we recorded a provision for loan losses of $840,000, which represents an increase of $140,000 or 20% over the $700,000 provision recorded in the corresponding nine months of last year. This is the result of current economic conditions, the growth in commercial real estate, construction and commercial business loans, which tend to be riskier than residential real estate loans, and an increase in non-performing loans as of September 30, 2010. (see “Financial Condition – Allowance for Loan Losses and Credit Quality Risk”).

For the three months ending September 30, 2010, we recorded a provision of $300,000 compared to $400,000 in 2009.

Non-interest Income

Non-interest income for the nine months ended September 30, 2010 totaled $4,359,000, an increase of $18,000 when compared to the same period in 2009. During the first nine months of 2010, investment security gains amounted to $99,000 compared to investment security gains of $118,000 last year. We sold two agency bonds at a gain of $9,000 and a mortgage backed security and U.S treasury note due to favorable market conditions for gains of $55,000 and $20,000, respectively in 2010. We also had two municipal bonds and an agency called that resulted in total gains of $15,000. In 2009, we sold an agency bond at a gain of $32,000 and several higher coupon mortgage-backed securities due to favorable market conditions realizing a total of $157,000 in gains. This was offset with a $16,000 loss on the sale of bank equity shares as well as an other than temporary impairment charge of $54,000 on our Freddie Mac preferred stock.

For the first nine months of 2010, account service charges totaled $2,709,000, an increase of $45,000 or 1.7%, when compared to the same period in 2009. There was a $133,000 increase attributable to customers’ usage of their debit cards due to continuing efforts on the Bank’s part to encourage customers to pay for items utilizing this payment method. This increase was offset by a decrease in fees charged to customers for non-sufficient funds of $67,000. Management is continuing to monitor the impact to the Company’s non-interest income as a result of recently enacted changes to regulations pertaining to the fees the Company can charge in regards to customer overdrafts (Regulation E).

Brokerage and insurance income increased $86,000 as we continue to increase the principal amounts invested through us by our customers by adding additional employees to serve our customers’ needs. Gains on loans sold decreased $200,000 compared to last year due to the significant amount of refinancing completed last year with the favorable rates in the secondary markets. The majority of the increase in other income is the result of two items that are related to the increase in other real estate owned. Rental income associated with these assets has increased $32,000 for the first nine months of 2010 compared to 2009. Additionally, for the first nine months of 2010, we have recognized gains on the sale of other real estate owned of $48,000. In the 2009, we had experienced a loss of $40,000 on the sale of other real estate owned, which was included in other expenses.

For the three month period ended September 30, 2010 service charges decreased by $39,000 compared to the same period in 2009. This decrease was the result of an $81,000 decrease in fees charged to customers for non-sufficient funds offset by increase of $46,000 attributable to customers' usage of their debit cards. Gains on loans sold decreased by $39,000 compared to last year's three months ended due to significantly higher refinancing activity in the secondary market last year. Other income increased $47,000 as a result of an increase of $22,000 in rental income from the increase in other real estate owned by the Bank, and a $13,000 increase in check cashing fee income as a result of the population increase created by the gas industry who are not customers of the Bank.

The following table shows the breakdown of non-interest income for the three and nine months ended September 30, 2010 and 2009:

	Nine months ended September 30,		Change	
	2010	2009	Amount	%
Service charges	$ 2,709	$ 2,664	$ 45	1.7
Trust	411	397	14	3.5
Brokerage and insurance	314	228	86	37.7
Gains on loans sold	92	292	(200)	(68.5)
Investment securities gains, net	99	118	(19)	(16.1)
Earnings on bank owned life insurance	376	364	12	3.3
Other	358	278	80	28.8
Total	$ 4,359	$ 4,341	$ 18	0.4

	Three months ended September 30,		Change	
	2010	2009	Amount	%
Service charges	$ 919	$ 958	$ (39)	(4.1)
Trust	130	121	9	7.4
Brokerage and insurance	91	75	16	21.3
Gains on loans sold	44	83	(39)	(47.0)
Investment securities gains, net	-	-	-	N/A
Earnings on bank owned life insurance	127	128	(1)	(0.8)
Other	134	87	47	54.0
Total	$ 1,445	$ 1,452	$ (7)	(0.5)

Non-interest Expense

Non-interest expenses decreased $143,000, or 1.1% for the nine months ended September 30, 2010 compared to the same period in 2009 due primarily to a decrease in FDIC Insurance expense. Salaries and employee benefits increased $275,000 due to annual merit increases effective the beginning of 2010 which are approximately $154,000, increased expense related to providing employee's insurance of $31,000, an $89,000 increase in the Company's Supplemental Executive Retirement Plan (SERP) plan and an $87,000 increase related to profit sharing expense. These expenses were partially offset by a decrease of $155,000 related to the Company's defined benefit pension plan.

FDIC Insurance decreased by $331,000 for the nine months ended September 30, 2010 compared to last year. During 2009, as a result of additional bank failures related to the economic crisis, the FDIC increased premiums and added a special assessment for insurance premiums, which resulted in a significantly higher level of fees. In lieu of an additional special assessment in the fourth quarter of 2009, the FDIC required assessments for the following three years, 2010 – 2012, to be prepaid in order to increase the monies available in the insurance fund. These prepayments, aggregating $2.8 million, will be recognized as a charge to operations over the applicable three year period.

Professional fees increased $50,000 due to various legal and consulting costs. The majority of the decrease in other expenses is due to a $108,000 decrease in amortization of intangibles is due to certain intangible assets becoming fully amortized in 2009.

For the three months ended, September 30, 2010, salaries and employee benefits increased by $43,000 due to the reasons described above, which include merit increases of $45,000, SERP expense of $48,000, profit sharing expenses of $26,000, offset by a decrease in pension of $97,000. The decrease in FDIC insurance for the quarter of $32,000 is attributable to the reasons discussed above. The decrease in other expenses is a result of a decrease in amortization expense of $36,000 as discussed above.

The following tables reflect the breakdown of non-interest expense and professional fees for the three and nine months ended September 30, 2010 and 2009:

	Nine months ended September 30, 2010	Nine months ended September 30, 2009	Change Amount	Change %
Salaries and employee benefits	$ 7,293	$ 7,018	$ 275	3.9
Occupancy	898	889	9	1.0
Furniture and equipment	331	336	(5)	(1.5)
Professional fees	509	459	50	10.9
FDIC Insurance	699	1,030	(331)	(32.1)
Other	3,440	3,581	(141)	(3.9)
Total	$ 13,170	$ 13,313	$ (143)	(1.1)

	Nine months ended September 30, 2010	Nine months ended September 30, 2009	Change Amount	Change %
Other professional fees	$ 250	$ 215	$ 35	16.3
Legal fees	95	70	25	35.7
Examinations and audits	164	174	(10)	(5.7)
Total	$ 509	$ 459	$ 50	10.9

	Three months ended September 30, 2010	Three months ended September 30, 2009	Change Amount	Change %
Salaries and employee benefits	$ 2,436	$ 2,393	$ 43	1.8
Occupancy	295	272	23	8.5
Furniture and equipment	114	102	12	11.8
Professional fees	176	164	12	7.3
FDIC Insurance	245	277	(32)	(11.6)
Other	1,220	1,242	(22)	(1.8)
Total	$ 4,486	$ 4,450	$ 36	0.8

	Three months ended June 30, 2010	Three months ended June 30, 2009	Change Amount	Change %
Other professional fees	$ 79	$ 69	$ 10	14.5

Legal fees		42		33	9	27.3
Examinations and audits		55		62	(7)	(11.3)
Total	$	176	$	164	$ 12	7.3

Provision For Income Taxes

The provision for income taxes was $2,348,000 for the nine month period ended September 30, 2010 compared to $1,941,000 for the same period in 2009. The increase is primarily attributable to an increase in income before provision for income taxes of $1,771,000. Through management of our municipal loan and bond portfolios, management is focused on minimizing our effective tax rate. Our effective tax rate was 21.5% and 21.2% for the first nine months of 2010 and 2009,respectively, compared to the statutory rate of 34%.

For the three-months ended September 30, 2010 the provision for income taxes was $775,000 compared to $604,000 for the same period in 2009. The increase is primarily attributable to an increase in income before provision for income taxes of $680,000.

We invest in three limited partnership agreements that established low-income housing projects in our market areas. As a result of these agreements, for tax purposes we have recognized the entire $913,000 of tax credits from one project in the Towanda area that began in October of 2000. We have recognized $337,000 out of a total $385,000 of tax credits on the second project in the Wellsboro market which was completed in November 2001. In 2005, we entered into a third limited liability partnership for a low-income housing project for senior citizens in our Sayre market area. We have recognized $215,000 out of a total $574,000 of tax credits. We anticipate recognizing $407,000 of tax credits over the next seven years, with a total $164,000 expected to be recognized in 2010.

Financial Condition

Total assets were $789.4 million at September 30, 2010, an increase of $59.9 million, or 8.2% from $729.5 million at December 31, 2009. Net loans increased 3.9% to $469.2 million and investment securities increased 16.1% to $230.5 million at September 30, 2010. Total deposits increased $49.7 million or 8.2% to $655.2 million since year-end 2009. Borrowed funds have increased $2.3 million to $56.5 million compared with $54.1 million at year-end.

Cash and Cash Equivalents

Cash and cash equivalents totaled $40.1 million at September 30, 2010 compared to $31.4 million at December 31, 2009, an increase of $8.6 million. The Company continues to hold significant cash reserves to invest in a future higher rate environment. Non-interest-bearing cash increased $1.9 million since year-end 2009, while interest-bearing cash increased $6.7 million during that same period. A portion of the increase in deposits over the first nine months has been offset by the increase in investment securities and loans issued during this time. Management actively measures and evaluates its liquidity through our Asset – Liability committee and believes its liquidity needs are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, Federal Home Loan Bank financing, federal funds lines with correspondent banks, brokered certificates of deposit and the portion of the investment and loan portfolios that mature within one year. Management expects that these sources of funds will permit us to meet cash obligations and off-balance sheet commitments as they come due.

Investments

Our investment portfolio increased by $31.9 million or 16.1% from December 31, 2009 to September 30, 2010. During 2010 we purchased approximately $49.8 million of U.S. agency obligations, $3.0 million of U.S. Treasury notes, $1.3 million of mortgage backed securities, $19.0 million of state and local obligations and $500,000 of equity securities, which help offset the $18.8 million of principal repayments and $16.9 million of calls that occurred during the year. We also sold $8.9 million of U.S agency obligations, U.S Treasury notes and mortgage backed securities at a net gain of $99,000. The overall market value of our investment portfolio increased approximately $3.3 million due to market fluctuations since year end. We have incurred significant unrealized gains in our U.S. agency obligations and state and local obligations since year end. Excluding our short-term investments consisting of monies held primarily at the Federal Reserve for liquidity purposes, our investment portfolio for the nine month period ending September 30, 2010 yielded 4.40% compared to 5.21% for the same period in 2009 on a tax equivalent basis.

As mentioned above and seen in the table below, due to the continued economic downturn and the low interest rates, we have experienced significant prepayments of our mortgage backed securities of $18.8 million and calls on our agency bonds and state and local obligations of $16.9 million. Due to the amount of cash flow from the investment portfolio as well as an increase in deposits and a lack of opportunities in other investment types, our strategy has been to reinvest funds mainly in short-term agency bonds (we purchased $49.8 million during the 2010 nine month period) and longer-term municipal bonds (we purchased $19.0 million during the 2010 nine month period). We believe this strategy will enable us to reinvest cash flows in the next one to four years when we expect investment opportunities to improve.

Fair Market Value of Investment Portfolio

(dollars in thousands)	September 30, 2010 Amount	%	December 31, 2009 Amount	%
Available-for-sale:				
U. S. Agency securities	$ 95,236	41.3	$ 65,223	32.8
Obligations of state & political subdivisions	79,297	34.4	59,574	30.0
Corporate obligations	3,337	1.4	3,166	1.6
Mortgage-backed securities	51,556	22.4	70,194	35.3
Equity securities	1,067	0.5	425	0.3
Total	$ 230,493	100.0	$ 198,582	100.0

(dollars in thousands)	September 30, 2010/ December 31, 2009 Change Amount	%
Available-for-sale:		
U. S. Agency securities	$ 30,013	46.0
Obligations of state & political subdivisions	19,723	33.1
Corporate obligations	171	5.4
Mortgage-backed securities	(18,638)	(26.6)
Equity securities	642	151.1
Total	$ 31,911	16.1

Management continues to monitor the earnings performance and the liquidity of the investment portfolio on a regular basis. Through active balance sheet management and analysis of the securities portfolio, the Company believes it maintains sufficient liquidity to satisfy depositor requirements and various credit needs of its customers.

Loans

The Company's lending is focused in the north central Pennsylvania market and the southern tier of New York. The composition of our loan portfolio consists principally of retail lending, which includes single-family residential mortgages and other consumer lending, and commercial lending primarily to locally owned small businesses. New loans are generated primarily from direct loans to our existing customer base, with new customers generated by referrals from real estate brokers, building contractors, attorneys, accountants and existing customers.

Total loans increased approximately $18.4 million or 4.0% during the first nine months of 2010. Commercial real estate, construction, commercial and other loans and loans to state and political subdivisions increased $12.0 million, $3.9 million, $4.7 million and $1.5 million, respectively. Residential real estate loans have decreased $3.3 million.

We have continued to experience lower demand for residential real estate and consumer loans due to several economic and competitive factors. Recessionary pressures, higher unemployment, and a depressed housing market have had a negative impact on nonconforming, residential real estate mortgage and home equity loan growth. Additionally, loan demand for conforming mortgages, which the Company sells on the secondary market, has also declined from last year as a result of increased competition from other local financial institutions. Through September 30, 2010, we have sold $6.7 million of loans in the secondary market compared to $17.8 million through this time last year. The Company recognizes fee income for servicing these sold loans, which is included in non-interest income on the consolidated statement of income. Despite the current lower level of loan demand, management continues to explore new competitively priced products that are attractive to our customers, and to build technologies which make it easier and more efficient for customers to choose the Company for their mortgage needs.

The growth in commercial real estate, construction, other commercial loans and state and political subdivision loans, despite the recessionary economic environment, reflects the Company's focus on commercial lending as a means to increase loan growth and obtain deposits from farmers and small businesses throughout our market area. We believe we have a strong team of experienced professionals and disciplined underwriting standards that enable us to meet the needs of these customers within our service area without incurring unreasonable risks.

	September 30 2010		December 31, 2009	
(in thousands)	Amount	%	Amount	%
Real estate:				
Residential	$ 191,655	40.4	$ 194,989	42.7
Commercial	145,954	30.7	133,953	29.4
Agricultural	19,366	4.1	19,485	4.3
Construction	9,565	2.0	5,619	1.2
Loans to individuals				
for household, family and other purchases	11,640	2.5	11,895	2.6
Commercial and other loans	48,820	10.3	44,101	9.7
State & political subdivision loans	47,792	10.0	46,342	10.1
Total loans	474,792	100.0	456,384	100.0
Less allowance for loan losses	5,588		4,888	
Net loans	$ 469,204		$ 451,496	

	September 30, 2010/ December 31, 2009 Change	
(in thousands)	Amount	%
Real estate:		
Residential	$ (3,334)	(1.7)
Commercial	12,001	9.0
Agricultural	(119)	(0.6)
Construction	3,946	70.2
Loans to individuals		
for household, family and other	(255)	(2.1)

purchases		
Commercial and other loans	4,719	10.7
State & political subdivision loans	1,450	3.1
Total loans	$ 18,408	4.0

Allowance For Loan Losses

The allowance for loan losses is maintained at a level, which in management's judgment is adequate to absorb probable future loan losses inherent in the loan portfolio. The provision for loan losses is charged against current income. Loans deemed not collectable are charged-off against the allowance while subsequent recoveries increase the allowance. The following table presents an analysis of the allowance for loan losses for the nine months ended September 30, 2010 and for the years ended December 31, 2009, 2008, 2007 and 2006:

	September 30 2010	December 31, 2009	2008	2007	2006
Balance at beginning of period	$ 4,888	$ 4,378	$ 4,197	$ 3,876	$ 3,664
Charge-offs:					
Real estate:					
Residential	47	76	31	64	37
Commercial	53	236	36	6	86
Agricultural	-	1	20	-	-
Loans to individuals for household, family and other purchases	26	80	44	103	103
Commercial and other loans	158	153	115	13	64
Total loans charged-off	284	546	246	186	290
Recoveries:					
Real estate:					
Residential	-	1	6	2	6
Commercial	12	1	-	79	115
Agricultural	-	-	20	-	-
Loans to individuals for household, family and other purchases	27	52	19	52	39
Commercial and other loans	105	77	52	9	12
Total loans recovered	144	131	97	142	172
Net loans charged-off (recovered)	140	415	149	44	118
Provision charged to expense	840	925	330	365	330
Balance at end of period	$ 5,588	$ 4,888	$ 4,378	$ 4,197	$ 3,876
Loans outstanding at end of period	$ 474,792	$ 456,384	$ 432,814	$ 423,379	$ 414,773
Average loans outstanding, net	$ 466,994	$ 442,921	$ 423,382	$ 411,927	$ 400,507

Non-performing assets:					
Non-accruing loans	$ 11,820	$ 5,871	$ 2,202	$ 1,915	$ 1,668
Accrual loans - 90 days or more past due	1,560	884	383	275	1,690
Total non-performing loans	$ 13,380	$ 6,755	$ 2,585	$ 2,190	$ 3,358
Foreclosed assets held for sale	890	302	591	203	758
Total non-performing assets	$ 14,270	$ 7,057	$ 3,176	$ 2,393	$ 4,116
Annualized net charge-offs to average loans	0.04%	0.09%	0.04%	0.01%	0.03%
Allowance to total loans	1.18%	1.07%	1.01%	0.99%	0.93%
Allowance to total non-performing loans	41.76%	72.36%	169.36%	191.64%	115.43%
Non-performing loans as a percent of loans					
net of unearned income	2.82%	1.48%	0.60%	0.52%	0.81%
Non-performing assets as a percent of loans					
net of unearned income	3.01%	1.55%	0.73%	0.57%	0.99%

The following table identifies amounts of loans contractually past due 30 to 90 days and non-performing loans by loan category, as well as the change from December 31, 2009 to September 30, 2010 in non-performing loans(dollars in thousands). Non-performing loans include those loans that are contractually past due 90 days or more and non-accrual loans. Interest does not accrue on non-accrual loans. Subsequent cash payments received are applied to the outstanding principal balance or recorded as interest income, depending upon management's assessment of its ultimate ability to collect principal and interest.

	September 30, 2010				December 31, 2009			
		Non-Performing Loans				Non-Performing Loans		
(in thousands)	30 - 90 Days Past Due	90 Days Past Due Accruing	Non-accrual	Total Non-Performing	30 - 90 Days Past Due	90 Days Past Due Accruing	Non-accrual	Total Non-Performing
Real estate:								
Residential	$ 1,245	$ 215	$ 467	$ 682	$ 1,629	$ 75	$ 810	$ 885
Commercial	1,585	1,305	7,523	8,828	1,558	635	1,863	2,498
Agricultural	-	18	2,301	2,319	75	-	2,094	2,094
Construction	-	-	-	-	-	-	749	749
Loans to individuals for household, family and other purchases	62	3	2	5	88	10	1	11
Commercial and other loans	57	19	1,527	1,546	610	75	354	429
State & political subdivision loans	-	-	-	-	-	89	-	89
Total nonperforming loans	$ 2,949	$ 1,560	$ 11,820	$ 13,380	$ 3,960	$ 884	$ 5,871	$ 6,755

	Change in Non-Performing Loans	
(in thousands)	Amount	%
Real estate:		
Residential	$ (203)	(22.9)
Commercial	6,330	253.4
Agricultural	225	10.7
Construction	(749)	(100.0)
Loans to individuals for household, family and other purchases	(6)	(54.5)
Commercial and other loans	1,117	260.4
State & political subdivision loans	(89)	(100.0)
Total nonperforming loans	$ 6,625	98.1

The Company utilizes a disciplined and thorough loan review process based upon our internal loan policy approved by the Company's Board of Directors. The purpose of the review is to assess loan quality, analyze delinquencies, identify problem loans, evaluate potential charge-offs and recoveries, and assess general overall economic conditions in the markets served. An external independent loan review is performed on our commercial portfolio semi-annually for the Company. As part of this review, our underwriting process and loan grading system is evaluated.

Management believes it uses the best information available to make such determinations and that the allowance for loan losses is adequate as of September 30, 2010. However, future adjustments could be required if circumstances differ substantially from assumptions and estimates used in making the initial determination. A prolonged downturn in the economy, continued high unemployment rates, significant changes in the value of collateral and delays in receiving financial information from borrowers could result in increased levels of non-performing assets, charge-offs, loan loss provisions and reduction in income. Additionally, bank regulatory agencies periodically examine the Bank's allowance for loan losses. The banking agencies could require the recognition of additions to the allowance for loan losses based upon their judgment of information available to them at the time of their examination.

On a monthly basis, problem loans are identified and updated primarily using internally prepared past due reports. Based on data surrounding the collection process of each identified loan, the loan may be added or deleted from the monthly watch list. The watch list includes loans graded special mention, substandard, doubtful, and loss, as well as additional loans that management may chose to include. Watch list loans are continually monitored going forward until satisfactory conditions exist that allow management to upgrade and remove the loan. In certain cases, loans may be placed on non-accrual status or charged-off based upon management's evaluation of the borrower's ability to pay. All commercial loans, which include commercial real estate, agricultural real estate, state and political subdivision loans and other commercial loans, on non-accrual are evaluated quarterly for impairment.

The adequacy of the allowance for loan losses is subject to a formal, quarterly analysis by management of the Company. In order to better analyze the risks associated with the loan portfolio, the entire portfolio is divided into several categories. As stated above, loans on non-accrual status are specifically reviewed for impairment and given a specific reserve, if appropriate. Loans evaluated and not found to be impaired are included with other performing loans, by category, by their respective homogenous pools. For the analysis prepared as of September 30, 2010, three year average historical loss factors were calculated for each pool and applied to the performing portion of the loan category. Previously, five year averages were utilized. Management believes that using a shorter experience period better reflects more current economic impacts and loan charge-off trends. The historical loss factors for both reviewed and homogeneous pools are adjusted based upon the following qualitative factors:

- § Level of and trends in charge-offs and recoveries
- § Trends in volume, terms and nature of the loan portfolio
- § Effects of any changes in risk selection and underwriting standards and any other changes in lending and recovery policies, procedures and practices
- § Changes in the quality of the Company's loan review system
- § Experience, ability and depth of lending management and other relevant staff
- § National, state, regional and local economic trends and business conditions
- § Industry conditions including the effects of external factors such as competition, legal, and regulatory requirements on the level of estimated credit losses.
- § Existence and effect of any credit concentrations, and changes in the level of such concentrations

The balance in the allowance for loan losses was $5,588,000 or 1.18% of total loans as of September 30, 2010 as compared to $4,888,000 or 1.07% of loans as of December 31, 2009. The $700,000 increase is a result of a $840,000 provision for the first nine months less net charge-offs of $140,000. Gross charge-offs for the first nine months of 2010 were $284,000. The following table shows the distribution of the allowance for loan losses and the percentage of loans compared to total loans by loan category (dollars in thousands) as of the nine months ended September 30, 2010 and for the years ended December 31, 2009, 2008, 2007 and 2006:

	September 30		December 31							
	2010		2009		2008		2007		2006	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Real estate loans:										
Residential	$ 866	40.4	$ 801	42.7	$ 694	46.0	$ 599	47.7	$ 614	49.7
Commercial, agricultural	3,372	34.8	2,864	33.6	2,303	28.8	2,128	27.7	1,676	26.8
Construction	25	2.0	20	1.2	5	2.6	-	2.7	-	1.7
Loans to individuals for household, family and other purchases	124	2.5	131	2.6	449	2.7	424	3.1	734	3.0
Commercial and other loans	1,037	10.3	918	9.7	807	8.8	736	8.2	582	7.9
State & political	129	10.0	93	10.1	19	11.1	22	10.6	22	10.9

subdivision loans										
Unallocated	35	N/A	60	N/A	101	N/A	288	N/A	248	N/A
Total allowance for loan losses	$ 5,588	100.0	$ 4,888	100.0	$ 4,378	100.0	$ 4,197	100.0	$ 3,876	100.0

For the nine month period ending September 30, 2010, we recorded a provision for loan losses of $840,000, which compares to $700,000 for the same time period in 2009. The increase is attributable to current economic conditions and an increase in non-performing loans in comparison to the same period last year. Non-performing loans increased $6.6 million or 98.1%, from December 31, 2009 to September 30, 2010. Approximately 90.6% of the Bank's non-performing loans are associated with the following six customer relationships:

- A commercial customer with a total loan relationship of $6.4 million secured by 140 residential properties and one commercial building requested a debt restructuring due to losses incurred as a result of investment losses unrelated to the customer's operations. This loan was placed on non-accrual status in the third quarter of 2010. Management of the Bank is continuing to gather additional information including updated appraisals on the collateral securing the debt and an understanding of the customer's current operations and cash flow from those operations to determine the extent, if any, of any loan impairment. During the third quarter, the Bank received 23 updated appraisals. The valuations calculated in the new appraisals approximated 84.9% of the original appraisal. For a separate 70 properties, management of the Bank performed an analysis of the collateral based upon an observation of the collateral and based on this observation assigned a percentage ranging from 100% to 50% depending on the condition of the collateral. This process resulted in a valuation that was approximately 85% of the original appraisals. Based on these two considerations, for the remaining properties, the Bank discounted the original appraisals by 15%. Utilizing the revised collateral values, the relationship has a loan to value ratio of approximately 84.9%. As of September 30, 2010, a specific allocation of the allowance for loan losses of $219,000 was allocated for these loans. This amount was determined by utilizing the revised collateral values and discounting for selling and holding costs. The Bank has not agreed to any restructuring and will wait until additional information is received and evaluated prior to making any decision related to the requested restructuring. Additionally, through October 31, 2010 all loans in this relationship are current with no historical loan delinquencies.
- An agricultural customer with a total loan relationship of $3.3 million is considered non-accrual as of September 30, 2010. Included within this relationship is $1.1 million of loans which are subject to Farm Service Agency guarantees. The current economic struggles of dairy farmers, caused primarily from decreased milk prices, have created cash flow difficulties for this customer. While we are hopeful that increased milk prices would significantly improve cash flows for this borrower, there is no certainty that this will occur. Without a sizable and sustained increase in milk prices, we will need to rely upon the collateral for repayment of interest and principal. A real estate appraisal was completed in October, 2009, which together with a collateral analysis on equipment and livestock, resulted in an updated collateral value of approximately $4.0 million. Based upon this analysis, management determined not to allocate a specific reserve to this loan. The customer's loan payments have been current since March 2010.
- A real estate rental customer with a total loan relationship of $412,000 is considered non-accrual as of September 30, 2010. The current recessionary economic conditions have significantly impacted the cash flows from the customer's rental properties. Based upon an analysis of the collateral value, management allocated a specific reserve of $19,000 to this loan. During the second quarter of 2010, the Bank completed a foreclosure action on a loan associated with this customer that had a balance of $678,000 at the time the foreclosure was completed. As of September 30, 2010, other assets include $570,000 related to this foreclosure as certain properties obtained as part of the foreclosure were sold in third quarter.
- A commercial customer with a total relationship of $469,000 composed of commercial real estate and other commercial loans was placed on non-accrual in 2010 due to inadequate cash flows as a result of the downturn in the economy, which has had a significant impact on his modular home business. Subsequent to September 30, 2010, the customer sold one modular home unit and the Bank received proceeds of $111,000 from this sale leaving a balance of approximately $358,000. Based upon an analysis of the collateral value, management determined not to allocate a specific reserve to this loan.
- A real estate rental customer with a total loan relationship of $544,000 is considered non-accrual as of September 30, 2010. The current recessionary economic conditions have significantly impacted the cash flows from the customer's rental properties. Subsequent to September 30, 2010, the customer sold several properties and the bank received proceeds from these sales of approximately $420,000 leaving a balance of approximately $124,000. Based upon an analysis of the remaining collateral values, management determined not to allocate a specific reserve to this loan.
- A commercial customer with a relationship of approximately $1.0 million is past due 90 days and still accruing as of September 30, 2010. The current recessionary economic conditions have significantly impacted the cash flows from the customer's activities. Management has reviewed the collateral and has determined that no specific reserve

is required as of September 30, 2010. Management will evaluate in the fourth quarter as to whether this loan should be placed on non-accrual.

The decrease in loans 30-89 days past due is primarily the result of approximately $514,000 of loans being considered nonaccrual as of September 30, 2010 that were less than 90 days past due as of December 31, 2009.

While the increase in the allowance of 14.3% and provision for loan losses of 20% have not matched the increase in the Bank's non-performing loans of 98.1%, Management of the Bank believe that the allowance for loan losses is adequate. This is based on the following factors:

- While non-performing loans have increased, $6.6 million or 98.1%, 72.1% of this balance or $9.6 million is current as of September 30, 2010. Additionally, as noted above, 90.6% of our non-performing loans are with 6 customers.
- Net and gross charge-offs continue to be low in relation to the size of the Bank's loan portfolio.
- We have not experienced the significant decrease in the collateral values of local residential, commercial or agricultural real estate loan portfolios as seen in other parts of the country during this current economic downturn. Real estate market values in our service area did not realize the significant, and sometimes speculative, increases as seen in other parts of the country prior to the current economic downturn. As such, the collateral value of our real estate loans has not significantly deteriorated with the downturn. In addition, our market area is predominately centered in the Marcellus Shale natural gas exploration and drilling area. These natural gas exploration and drilling activities have significantly impacted the overall interest in real estate in our market area due to the related lease and royalty revenues associated with it. The natural gas activities have had a positive impact on the value of local real estate.

Bank Owned Life Insurance

The Company purchased bank owned life insurance to offset future employee benefit costs. As of September 30, 2010 the cash surrender value of this life insurance is $13,043,000, which has resulted in income recognized in the first nine months ended September 30, 2010 of $376,000 compared to $364,000 for the same period in 2009. The use of life insurance policies provides the Bank with an asset that will generate earnings to partially offset the current costs of benefits, and eventually (at the death of the individuals) provides partial recovery of cash outflows associated with the benefits.

Premises and Equipment

Premises and equipment increased approximately $717,000 from $12.2 at December 31, 2009 to $12.9 at September 30, 2010, an increase of 5.9%. This occurred primarily as a result of the new branch construction in Wellsboro, Pennsylvania that was completed in August 2010, which amounted to approximately $1.1 million during the first nine months of 2010, offset by depreciation of $491,000 during the first nine months of 2010.

Deposits

Deposits increased $49.7 million or 8.2%, since December 31, 2009. The increase in deposits is due to several reasons. As previously mentioned our market area has been positively impacted by oil and gas exploration activities. We have developed targeted products to meet the needs of customers benefiting from this activity. The overall turbulence and volatility in the financial markets has also resulted in customers seeking more stability in their deposits. Finally, our ability to work with local municipalities to meet their business needs has resulted in increased deposits.

As of September 30, 2010, non-interest-bearing deposits, NOW accounts, savings accounts and money market deposit accounts, have all increased by $8.7 million, $24.9 million, $10.0 million, and $8.2 million, respectively, from December 31, 2009. Certificates of deposit have decreased $2.1 million since December 31, 2009, as a result of customers investing in other options in this low rate environment. As mentioned, oil and gas exploration has had a significant impact on this segment as well. The Bank currently does not have any outstanding brokered certificates of deposit.

	September 30 2010		December 31, 2009	
(in thousands)	Amount	%	Amount	%
Non-interest-bearing deposits	$ 68,794	10.5	$ 60,061	9.9
NOW accounts	161,042	24.6	136,153	22.5
Savings deposits	59,016	9.0	49,049	8.1
Money market deposit accounts	50,364	7.7	42,210	7.0
Certificates of deposit	316,024	48.2	318,086	52.5
Total	$ 655,240	100.0	$ 605,559	100.0

	June 30, 2010/ December 31, 2009 Change	
(in thousands)	Amount	%
Non-interest-bearing deposits	$ 8,733	14.5
NOW accounts	24,889	18.3
Savings deposits	9,967	20.3
Money market deposit accounts	8,154	19.3
Certificates of deposit	(2,062)	(0.6)
Total	$ 49,681	8.2

Borrowed Funds

Borrowed funds increased $2.3 million during the first nine months of 2010. The majority of this increase is the result of one new customer obtained by the Bank in 2010 utilizing repurchase agreements. During the nine months ended September 30, 2010, the Bank had $3.0 million of long-term borrowings with the Federal Home Loan Bank of Pittsburgh mature and borrowed $3.0 million from the Federal Home Loan Bank of Pittsburgh. The Bank’s current strategy for borrowings is to replace any maturities with five to seven year borrowings due to the current interest rate environment. The Company's daily cash requirements or short-term investments are primarily met by using the financial instruments available primarily through the Federal Home Loan Bank of Pittsburgh.

In December 2003, the Company formed a special purpose entity, Citizens Financial Statutory Trust I (“the Entity”), to issue $7,500,000 of floating rate obligated mandatory redeemable securities as part of a pooled offering. The rate is determined quarterly based on the 3 month LIBOR plus 2.80%. The Entity may redeem them, in whole or in part, at face value at any time. The Company borrowed the proceeds of the issuance from the Entity in December 2003 in the form of a $7,500,000 note payable, which is included within “Borrowed Funds” in the liabilities section of the Company’s balance sheet. Under current accounting rules, the Company’s minority interest in the Entity was recorded at the initial investment amount and is included in the other assets section of the balance sheet. The Entity is not consolidated as part of the Company’s consolidated financial statements.

In December, 2008, the Company entered into an interest rate swap agreement to convert the above mentioned floating-rate debt to fixed rate debt on a notional amount of $7.5 million. The interest rate swap instrument involves an agreement to receive a floating rate and pay a fixed rate, at specified intervals, calculated on the agreed-upon notional amount. The differentials paid or received on interest rate swap agreements are recognized as adjustments to interest expense in the period. The interest rate swap agreement was entered into on December 17, 2008 and expires December 17, 2013. The fair value of the interest rate swap at September 30, 2010 was a liability of $520,000 and is included within other liabilities on the Consolidated Balance Sheet.

Stockholder's Equity

We evaluate stockholders' equity in relation to total assets and the risks associated with those assets. The greater the capital resource, the more likely a corporation will meet its cash obligations and absorb unforeseen losses. For these reasons, capital adequacy has been, and will continue to be, of paramount importance.

Total stockholders' equity was $69.6 million at September 30, 2010 compared to $61.5 million at December 31, 2009, an increase of $8.1 million or 13.2%. Excluding accumulated other comprehensive income, stockholder's equity increased $6.2 million, or 10.3%. In the first nine months of 2010, the Company had net income of $8.6 million and paid dividends of $2.2 million, representing a dividend payout ratio of 25.6%. The Company purchased 13,723 shares of treasury stock at a weighted average cost of $27.75 per share. From treasury stock, the Company also awarded 5,090 shares of restricted stock to employees and 800 shares to the Board of Directors under equity incentive programs. During the nine month period ended September 30, 2010, two employees with 467 unvested shares of restricted stock resigned, which were transferred to treasury stock.

All of the Company's investment securities are classified as available-for-sale, making this portion of the Company's balance sheet more sensitive to the changing market value of investments. Accumulated other comprehensive income increased $1.9 million from December 31, 2009 as a result of market value fluctuations.

The Company has also complied with standards of being well capitalized mandated by the banking regulators. The Company's primary regulators have established "risk-based" capital requirements designed to measure capital adequacy. Risk-based capital ratios reflect the relative risks associated with various assets entities hold in their portfolios. A weight category of 0% (lowest risk assets), 20%, 50%, or 100% (highest risk assets), is assigned to each asset on the balance sheet. The Company's computed risk-based capital ratios are as follows:

(dollars in thousands)	September 30 2010		December 31, 2009	
Total capital (to risk-weighted assets)	Amount	Ratio	Amount	Ratio
Company	$69,912	14.60%	$62,751	13.77%
For capital adequacy purposes	38,299	8.00%	36,464	8.00%
To be well capitalized	47,874	10.00%	45,580	10.00%
Tier I capital (to risk-weighted assets)				
Company	$64,255	13.42%	$57,839	12.69%
For capital adequacy purposes	19,150	4.00%	18,232	4.00%
To be well capitalized	28,724	6.00%	27,348	6.00%

Tier I capital (to average assets)				
Company	$64,255	8.37%	$57,839	8.15%
For capital adequacy purposes	30,709	4.00%	28,381	4.00%
To be well capitalized	38,386	5.00%	35,478	5.00%

The Bank's computed risk-based capital ratios are as follows:

(dollars in thousands)	September 30 2010		December 31, 2009	
Total capital (to risk-weighted assets)	Amount	Ratio	Amount	Ratio
Bank	$64,466	13.50%	$57,182	12.56%
For capital adequacy purposes	38,191	8.00%	36,414	8.00%
To be well capitalized	47,739	10.00%	45,518	10.00%
Tier I capital (to risk-weighted assets)				
Bank	$58,878	12.33%	$52,286	11.49%
For capital adequacy purposes	19,096	4.00%	18,207	4.00%
To be well capitalized	28,643	6.00%	27,311	6.00%
Tier I capital (to average assets)				
Bank	$58,878	7.68%	$52,286	7.38%
For capital adequacy purposes	30,652	4.00%	28,348	4.00%
To be well capitalized	38,316	5.00%	35,436	5.00%

Off Balance Sheet Activities

Some financial instruments, such as loan commitments, credit lines, and letters of credit are issued to meet customer financing needs. The contractual amount of financial instruments with off-balance sheet risk was as follows at September 30, 2010 (dollars in thousands):

Commitments to extend credit	$75,343
Standby letters of credit	4,482

$79,825

We also offer limited overdraft protection as a non-contractual courtesy which is available to demand deposit accounts in good standing for personal. Effective in the third quarter of 2010, overdraft charges as a result of ATM withdrawals and one time point of sale (non-recurring) transactions require prior approval of the customer. The non-contractual amount of financial instruments with off-balance sheet risk at September 30, 2010 was $10,788,000. The Company reserves the right to discontinue this service without prior notice.

Liquidity

Liquidity is a measure of the Company's ability to efficiently meet normal cash flow requirements of both borrowers and depositors. To maintain proper liquidity, we use funds management policies along with our investment policies to assure we can meet our financial obligations to depositors, credit customers and stockholders. Liquidity is needed to meet depositors' withdrawal demands, extend credit to meet borrowers' needs, provide funds for normal operating expenses and cash dividends, and to fund other capital expenditures.

Cash generated by operating activities, investing activities and financing activities influences liquidity management. Our Company's historical activity in this area can be seen in the Consolidated Statement of Cash Flows. The most important source of funds is the deposits that are primarily core. Repayment of principal on outstanding loans and cash flows created from the investment portfolio also a factor in liquidity management. Other sources of funding include brokered certificates of deposit and the sale of loans or investments, if needed.

The Company's use of funds is shown in the investing activity section of the Consolidated Statement of Cash Flows, where the net loan activity is presented. Other significant uses of funds include purchasing stock from the Federal Home Loan Bank (FHLB) of Pittsburgh, as well as capital expenditures. Capital expenditures during the first nine months of 2010 were $1.2 million, compared to $1.1 million during the same time period in 2009. Our new branch construction in Wellsboro, Pennsylvania accounted for most of the expenditure in 2010, while the construction of the new branch in Troy accounted for the expenditures in 2009.

Short-term debt from the FHLB supplements the Bank's availability of funds. The Bank achieves liquidity primarily from temporary or short-term investments in the Federal Reserve and the FHLB. The Bank has a maximum borrowing capacity at the FHLB of approximately $271.9 million, of which $39.0 million was outstanding at September 30, 2010. Additionally, we have a Federal funds line totaling $10.0 million from a third party bank at market rates. This line is not drawn upon. We also have borrower in custody line with the Federal Reserve Board of approximately $13.5 million, which also is not drawn upon as of September 30, 2010.

Citizens Financial is a separate legal entity from the Bank and must provide for its own liquidity. In addition to its operating expenses, Citizens Financial is responsible for paying any dividends declared to its shareholders. Citizens Financial also has repurchased shares of its common stock. Citizens Financial's primary source of income is dividends received from the Bank. The Bank may not, under the National Bank Act, declare a dividend without approval of the OCC, unless the dividend to be declared by the Bank's Board of Directors does not exceed the total of: (i) the Bank's net profits for the current year to date, plus (ii) its retained net profits for the preceding two current years, less any required transfers to surplus. In addition, the Bank can only pay dividends to the extent that its retained net profits (including the portion transferred to surplus) exceed its bad debts. The Federal Reserve Board, the OCC and the FDIC have formal and informal policies which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings, with some exceptions. The Prompt Corrective Action Rules, described above, further limit the ability of banks to pay dividends, because banks which are not classified as well capitalized or adequately capitalized may not pay dividends and no dividend may be paid which would make the Bank undercapitalized after the dividend. At September 30, 2010, Citizens Financial had liquid assets of $5.3 million.

Interest Rate and Market Risk Management

The objective of interest rate sensitivity management is to maintain an appropriate balance between the stable growth of income and the risks associated with maximizing income through interest sensitivity imbalances and the market value risk of assets and liabilities.

Because of the nature of our operations, we are not subject to foreign currency exchange or commodity price risk and, since our Company has no trading portfolio, it is not subject to trading risk.

Currently, our Company has equity securities that represent only .5% of our investment portfolio and, therefore, equity risk is not significant.

The primary components of interest-sensitive assets include adjustable-rate loans and investments, loan repayments, investment maturities and money market investments. The primary components of interest-sensitive liabilities include maturing certificates of deposit, IRA certificates of deposit and short-term borrowings. Savings deposits, NOW accounts and money market investor accounts are considered core deposits and are not short-term interest sensitive (except for the top-tier money market investor accounts which are paid current market interest rates).

Gap analysis, one of the methods used by us to analyze interest rate risk, does not necessarily show the precise impact of specific interest rate movements on our Company's net interest income because the re-pricing of certain assets and liabilities is discretionary and is subject to competitive and other pressures. In addition, assets and liabilities within the same period may, in fact, be repaid at different times and at different rate levels. We have not experienced the kind of earnings volatility that might be indicated from gap analysis.

Our Company currently uses a computer simulation model to better measure the impact of interest rate changes on net interest income. We use the model as part of our risk management process that will effectively identify, measure, and monitor our Company's risk exposure.

We use numerous interest rate simulations employing a variety of assumptions to evaluate our interest rate risk exposure. A shock analysis during the third quarter of 2010 indicated that a 200 basis point movement in interest rates in either direction would have a minor impact on our Company's anticipated net interest income over the next twelve to twenty-four months.

Item 3-Quantitative and Qualitative Disclosure About Market Risk

In the normal course of conducting business activities, the Company is exposed to market risk, principally interest rate risk, through the operations of its banking subsidiary. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and values of financial instruments and was discussed previously in this Form 10-Q. Management and a committee of the Board of Directors manage interest rate risk (see also “Interest Rate and Market Risk Management”).

No material changes in market risk strategy occurred during the current period. A detailed discussion of market risk is provided in the SEC Form 10-K for the period ended December 31, 2009.

Item 4-Control and Procedures

(a) Disclosure Controls and Procedures

The Company’s management, including the Company’s principal executive officer and principal financial officer, have evaluated the effectiveness of the Company’s “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the “Exchange Act”). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company’s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the “SEC”) (1) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (2) is accumulated and communicated to the Company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes to Internal Control Over Financial Reporting

There were no changes in the Company’s internal control over financial reporting during the three months ended September 30, 2010 that have materially affected, or are reasonable likely to materially affect, the Company’s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

Management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of the Company. Any pending proceedings are ordinary, routine litigation incidental to the business of the Company and its subsidiary. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Company and its subsidiary by government authorities.

Item 1A – Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1.A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009, which could materially affect our business, financial condition or future results. Other than noted below, at September 30, 2010 the risk factors of the Company have not changed materially from those reported in our Annual Report on Form 10-K. However, the risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

On July 21, 2010, the President signed into law The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Dodd-Frank Act restructures the regulation of depository institutions. The Dodd-Frank Act contains various provisions designed to enhance the regulation of depository institutions and prevent the recurrence of a financial crisis such as occurred in 2008-2009. Also included is the creation of a new federal agency to administer and enforce consumer and fair lending laws, a function that is now performed by the depository institution regulators. The federal preemption of state laws currently accorded federally chartered depository institutions will be reduced as well. The full impact of the Dodd-Frank Act on our business and operations will not be known for years until regulations implementing the statute are written and adopted. The Dodd-Frank Act may have a material impact on our operations, particularly through increased compliance costs resulting from possible future consumer and fair lending regulations.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares (or units Purchased)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans of Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (1)
7/1/10 to 7/31/10	-	$0.00	-	37,253
8/1/10 to 8/31/10	63	$26.00	63	37,190
9/1/10 to 9/30/10	188	$29.00	188	37,002
Total	251	$28.25	251	37,002

(1) On January 7, 2006, the Company announced that the Board of Directors authorized the Company to repurchase up to 140,000 shares. The repurchases will be conducted through open-market purchases or privately negotiated transactions and will be made from time to time depending on market conditions and other factors. No time limit was placed on the duration of the share repurchase program. Any repurchased shares will be held as treasury stock and will be available for general corporate purposes.

Item 3 - Defaults Upon Senior Securities

Not applicable.

Item 4 – [Removed and reserved]

Item 5 - Other Information

None

Item 6 - Exhibits

(a) The following documents are filed as a part of this report:

3.1	Articles of Incorporation of Citizens Financial Services, Inc., as amended (1)
3.2	Bylaws of Citizens Financial Services, Inc.(2)
4.1	Instrument defining the rights of security holders.(3)
4.2	No long term debt instrument issued by the Company exceeds 10% of consolidated assets or is registered. In accordance with paragraph 4(iii) of Item 601(b) of Regulation S-K, the Company will furnish the Securities and Exchange Commission copies of long-term debt instruments and related agreements upon request.
10.1	*First Citizens National Bank Annual Incentive Plan
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer

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* Management contract or compensatory plan, contract or arrangement.

(1) Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010, as filed with the Commission on May 12, 2010.

(2) Incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K, as filed with the Commission on December 24, 2009.

(3) Incorporated by reference to Exhibit 4 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the Commission on March 14, 2006.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the undersigned Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

	Citizens Financial Services, Inc.	
November 12, 2010	By:	/s/ Randall E. Black By: Randall E. Black President and Chief Executive Officer (Principal Executive Officer)
November 12, 2010	By:	/s/ Mickey L. Jones By: Mickey L. Jones Chief Financial Officer (Principal Accounting Officer)

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