

CHEMUNG FINANCIAL CORP

Form 10-Q

May 14, 2012

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON D.C. 20549

FORM 10-Q

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

For Quarterly period ended March 31, 2012

Or

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

Commission File No. 0-13888

CHEMUNG FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

New York  
(State or other jurisdiction of incorporation or organization)

16-1237038  
I.R.S. Employer Identification No.

One Chemung Canal Plaza, P.O. Box 1522, Elmira, NY  
(Address of principal executive offices)

14902  
(Zip Code)

(607) 737-3711 or (800) 836-3711  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required 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: ☒ 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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Non-accelerated filer	<input type="checkbox"/>
Accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):  
YES: ☐ NO: ☒

The number of shares of the registrant's common stock, \$.01 par value, outstanding on April 30, 2012 was 4,574,239.



CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

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## PART I. FINANCIAL INFORMATION

## Item 1: Financial Statements

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)

	MARCH 31, 2012	DECEMBER 31, 2011
<b>ASSETS</b>		
Cash and due from financial institutions	\$ 27,311,509	\$ 28,204,699
Interest-bearing deposits in other financial institutions	83,202,900	24,697,154
Total cash and cash equivalents	110,514,409	52,901,853
Trading assets, at fair value	254,243	294,381
Securities available for sale, at estimated fair value	259,449,877	280,869,810
Securities held to maturity, estimated fair value of \$8,206,472 at March 31, 2012 and \$9,175,956 at December 31, 2011	7,446,817	8,311,921
Federal Home Loan Bank and Federal Reserve Bank Stock, at cost	5,435,800	5,509,350
Loans, net of deferred origination fees and costs, and unearned income	803,033,067	796,915,177
Allowance for loan losses	(10,283,289)	(9,659,320)
Loans, net	792,749,778	787,255,857
Loans held for sale	825,850	395,427
Premises and equipment, net	24,976,937	24,762,405
Goodwill	21,824,443	21,983,617
Other intangible assets, net	5,906,400	6,190,540
Bank owned life insurance	2,646,629	2,625,104
Other assets	22,463,763	25,159,322
Total assets	\$ 1,254,494,946	\$ 1,216,259,587
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Deposits:</b>		
Non-interest-bearing	\$ 272,055,263	\$ 258,835,961
Interest-bearing	766,650,126	739,656,878
Total deposits	1,038,705,389	998,492,839

Securities sold under agreements to repurchase	34,998,443	37,106,842
Federal Home Loan Bank term advances	43,227,341	43,343,918
Accrued interest payable	675,784	800,148
Dividends payable	1,143,923	1,141,081
Other liabilities	6,915,320	9,445,319
Total liabilities	1,125,666,200	1,090,330,147

## Shareholders' equity:

Common stock, \$.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at March 31, 2012 and December 31, 2011	53,101	53,101
Additional-paid-in capital	45,556,436	45,582,861
Retained earnings	103,099,510	100,628,900
Treasury stock, at cost (734,887 shares at March 31, 2012; 741,003 shares at December 31, 2011)	(18,734,217)	(18,894,044)
Accumulated other comprehensive income (loss)	(1,146,084)	(1,441,378)
Total shareholders' equity	128,828,746	125,929,440
Total liabilities and shareholders' equity	\$ 1,254,494,946	\$ 1,216,259,587

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(UNAUDITED)

	Three Months Ended	
	March 31,	March 31,
	2012	2011
Interest and dividend income:		
Loans, including fees	\$ 11,670,912	\$ 8,575,343
Taxable securities	1,486,351	1,248,586
Tax exempt securities	340,622	315,423
Interest-bearing deposits	41,782	39,727
Total interest and dividend income	13,539,667	10,179,079
Interest expense:		
Deposits	927,983	1,027,365
Borrowed funds	313,039	234,425
Securities sold under agreements to repurchase	282,772	371,099
Total interest expense	1,523,794	1,632,889
Net interest income	12,015,873	8,546,190
Provision for loan losses	477,305	125,000
Net interest income after provision for loan losses	11,538,568	8,421,190
Other operating income:		
Wealth management group fee income	1,775,576	1,615,691
Service charges on deposit accounts	991,880	983,078
Net gain on securities transactions	297,169	193,398
Other-than-temporary loss on investment securities:		
Total impairment losses	-	-
Loss recognized in other comprehensive income	-	-
Net impairment loss recognized in earnings	-	-
Net gain on sales of loans held for sale	65,340	46,932
Casualty gains	758,857	-
	21,525	21,587



Income from bank owned life insurance		
Other	986,510	1,486,806
Total other operating income	4,896,857	4,347,492

Other operating expenses:

Salaries and wages	4,492,675	3,923,505
Pension and other employee benefits	1,289,940	1,043,107
Net occupancy expenses	1,294,877	1,174,042
Furniture and equipment expenses	518,366	497,447
Data processing expense	1,077,483	861,813
Amortization of intangible assets	284,140	176,503
Marketing and advertising expense	289,239	212,555
Losses on sales of other real estate owned	6,459	1,671
Other real estate owned expenses	43,479	27,223
FDIC insurance	226,631	252,395
Merger related expenses	4,545	1,036,072
Other	1,394,512	1,237,305
Total other operating expenses	10,922,346	10,443,638

Income before income tax expense	5,513,079	2,325,044
Income tax expense	1,898,546	660,029
Net income	\$ 3,614,533	\$ 1,665,015

Weighted average shares outstanding	4,642,012	3,624,434
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Basic and diluted earnings per share	\$ 0.78	\$ 0.46
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See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(UNAUDITED)

	Three Months Ended March 31,	
	2012	2011
Net income	\$3,614,533	\$1,665,015
Other comprehensive income		
Unrealized holding gains on securities available for sale	514,361	747,372
Change in unrealized losses on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in earnings, net of reclassification	-	-
Reclassification adjustment gains realized in net income	(297,169)	(193,398)
Net unrealized gains	217,192	553,974
Less: Tax effect	115,666	214,310
Net of tax amount	101,526	339,664
Change in funded status of defined benefit pension plan and other benefit plans	314,763	154,699
Less: Tax effect	120,995	59,847
Net of tax amount	193,768	94,852
Total other comprehensive income	295,294	434,516
Comprehensive income	\$3,909,827	\$2,099,531

See accompanying notes to unaudited  
consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(UNAUDITED)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balances at December 31, 2010	\$ 43,001	\$ 22,022,122	\$ 94,407,620	\$ (19,166,655)	\$ 102,475	\$ 97,408,563
Net income	-	-	1,665,015	-	-	1,665,015
Other comprehensive income	-	-	-	-	434,516	434,516
Restricted stock awards	-	6,254	-	-	-	6,254
Restricted stock units for directors' deferred compensation plan	-	24,968	-	-	-	24,968
Cash dividends declared (\$0.25 per share)	-	-	(891,403)	-	-	(891,403)
Distribution of 10,378 shares of treasury stock for directors' compensation	-	(33,831)	-	265,262	-	231,431
Distribution of 2,392 shares of treasury stock for employee compensation	-	(6,140)	-	61,140	-	55,000
Distribution of 286 shares of treasury stock for deferred directors' compensation	-	(7,363)	-	7,310	-	(53)
Distribution of 2,300 shares of treasury stock for employee restricted stock awards	-	(7,498)	-	58,788	-	51,290
Balances at March 31, 2011	\$ 43,001	\$ 21,998,512	\$ 95,181,232	\$ (18,774,155)	\$ 536,991	\$ 98,985,581
Balances at December 31, 2011	\$ 53,101	\$ 45,582,861	\$ 100,628,900	\$ (18,894,044)	\$ (1,441,378)	\$ 125,929,440
Net income	-	-	3,614,533	-	-	3,614,533
Other comprehensive income	-	-	-	-	295,294	295,294
Restricted stock awards	-	15,922	-	-	-	15,922

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Restricted stock units for directors' deferred compensation plan	-	21,340	-	-	-	21,340
Cash dividends declared (\$0.25 per share)	-	-	(1,143,923)	-	-	(1,143,923)
Distribution of 10,238 shares of treasury stock for directors' compensation	-	(28,121)	-	261,069	-	232,948
Distribution of 3,453 shares of treasury stock for employee compensation	-	(8,052)	-	88,052	-	80,000
Distribution of 1,079 shares of treasury stock for employee restricted stock awards	-	(27,514)	-	27,514	-	-
Purchase of 8,654 shares of treasury stock	-	-	-	(216,808)	-	(216,808)

Balances at March 31, 2012	\$ 53,101	\$ 45,556,436	\$ 103,099,510	\$ (18,734,217)	\$ (1,146,084)	\$ 128,828,746
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See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

Three Months Ended March 31,

CASH FLOWS FROM

OPERATING ACTIVITIES:

	2012	2011
Net income	\$ 3,614,533	\$ 1,665,015

Adjustments to reconcile net income to net cash provided by operating activities:

Amortization of intangible assets	284,140	176,503
Provision for loan losses	477,305	125,000
Depreciation and amortization of fixed assets	740,442	704,659

Amortization of premiums on securities, net	415,183	195,308
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Gains on sales of loans held for sale, net	(65,340)	(46,932)
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Proceeds from sales of loans held for sale	2,345,590	2,325,959
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Loans originated and held for sale	(2,710,673)	(1,819,218)
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Net losses on sale of other real estate owned	6,459	1,671
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Net gains on trading assets	(13,122)	(8,793)
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Net gains on securities transactions	(297,169)	(193,398)
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Proceeds from sales of trading assets	72,646	-
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Purchase of trading assets	(19,386)	(227,287)
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Decrease (increase) in other assets	2,329,896	(414,556)
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Decrease in prepaid FDIC assessment	207,849	234,174
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Decrease in accrued interest payable	(124,364)	(81,239)
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Expense related to restricted stock units for directors' deferred compensation plan	21,340	24,968
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Expense related to employee stock compensation	80,000	55,000
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Expense related to employee stock awards	15,922	6,254
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Decrease in other liabilities	(2,218,951)	(1,831,697)
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Income from bank owned life insurance	(21,525)	(21,587)
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Net cash provided by operating activities	5,140,775	869,804
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CASH FLOWS FROM

INVESTING ACTIVITIES:

Proceeds from sales and calls of securities available for sale	52,579,688	50,170,898
Proceeds from maturities and principal collected on securities available for sale	6,881,564	8,404,592
Proceeds from maturities and principal collected on securities held to maturity	1,090,104	172,790
Purchases of securities available for sale	(37,942,141)	(69,419,853)
Purchases of securities held to maturity	(225,000)	(1,973,274)
Purchase of Federal Home Loan Bank and Federal Reserve Bank stock	(1,550)	-
Redemption of Federal Home Loan Bank and Federal Reserve Bank stock	75,100	121,900
Purchases of premises and equipment	(954,974)	(238,718)
Proceeds from sales of other real estate owned	34,555	36,809
Net (increase) decrease in loans	(5,695,251)	1,139,806

Net cash provided (used) by investing activities	15,842,095	(11,585,050)
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**CASH FLOWS FROM  
FINANCING ACTIVITIES:**

Net increase in demand deposits, NOW accounts, savings accounts, and insured money market accounts	54,238,429	32,078,587
Net decrease in time deposits and individual retirement accounts	(14,025,878)	(217,109)
Net decrease in securities sold under agreements to repurchase	(2,108,399)	(2,863,867)
Repayments of Federal Home Loan Bank long term advances	(116,577)	-
Purchase of treasury stock	(216,808)	-

Cash dividends paid	(1,141,081)	(881,203)
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Net cash provided by financing activities	36,629,686	28,116,408
Net increase in cash and cash equivalents	57,612,556	17,401,162
Cash and cash equivalents, beginning of period	52,901,853	60,619,777
Cash and cash equivalents, end of period	\$ 110,514,409	\$ 78,020,939

Supplemental disclosure of cash  
flow information:

## Cash paid during the year for:

Interest	\$ 1,648,158	\$ 1,714,128
Income Taxes	\$ 875	\$ 309,686

Supplemental disclosure of  
non-cash activity:

Transfer of loans to other real estate owned	\$ 116,800	\$ -
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See accompanying notes to  
unaudited consolidated financial  
statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Chemung Financial Corporation (the "Corporation"), through its wholly owned subsidiaries, Chemung Canal Trust Company (the "Bank") and CFS Group, Inc., a financial services company, provides a wide range of banking, financing, fiduciary and other financial services to its local market area. The consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries. All material intercompany accounts and transactions are eliminated in consolidation.

The data in the consolidated balance sheet as of December 31, 2011 was derived from the audited consolidated financial statements in the Corporation's 2011 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 28, 2012. That data, along with the other interim financial information presented in the consolidated balance sheets, statements of income, shareholders' equity and comprehensive income, and cash flows should be read in conjunction with the audited consolidated financial statements, including the notes thereto, contained in the 2011 Annual Report on Form 10-K. Amounts in prior periods' consolidated interim financial statements are reclassified whenever necessary to conform to the current period's presentation.

The consolidated financial statements included herein reflect all adjustments which are, in the opinion of management, of a normal recurring nature and necessary to present fairly the Corporation's financial position as of March 31, 2012 and December 31, 2011, and results of operations for the three-month periods ended March 31, 2012 and 2011, and changes in shareholders' equity and cash flows for the three-month periods ended March 31, 2012 and 2011. Subsequent events were evaluated for any required recognition or disclosure. The results for the periods presented are not necessarily indicative of results to be expected for the entire fiscal year or any other interim period.

2. Earnings Per Common Share

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors' restricted stock units and directors' stock compensation, are considered outstanding and are included in the computation of basic earnings per share as they are earned. All outstanding unvested share based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities. The impact of the participating securities on earnings per share is not material. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,642,012 and 3,624,434 weighted average shares outstanding for the three-month periods ended March 31, 2012 and 2011, respectively. There were no dilutive common stock equivalents during the three-month periods ended March 31, 2012 or 2011.



### 3. Adoption of New Accounting Standards

In May, 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this guidance are effective for interim and annual reporting periods beginning after December 15, 2011. The effect of adopting this standard did not have a material effect on the Corporation's operating results or financial condition, but the additional disclosures are included in Note 4.

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholder's equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. The amendments in this guidance are effective as of the beginning of a fiscal reporting year, and interim periods within that year, that begins after December 15, 2011. In connection with the adoption of this amendment, the Corporation changed the presentation of the statement of comprehensive income for the Corporation to two consecutive statements instead of presenting it as part of the consolidated statements of shareholder's equity.

### 4. Fair Value

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods and significant assumptions to estimate fair value:

Investment Securities: The fair values of securities available for sale are usually determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs), or matrix pricing, which is a mathematical technique widely used to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

The Corporation's investment in collateralized debt obligations consisting of pooled trust preferred securities which are issued by financial institutions were historically priced using Level 2 inputs. The lack of observable inputs and market activity in this class of investments has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, have varied

widely. The once active market has become comparatively inactive. As a result, these investments are now priced using Level 3 inputs.

The Corporation has developed an internal model for pricing these securities. This is the same model used in determining other-than-temporary impairment (“OTTI”) as further described in Note 8. Information such as historical and current performance of the underlying collateral, deferral/default rates, collateral coverage ratios, break in yield calculations, cash flow projections, liquidity and credit premiums required by a market participant, and financial trend analysis with respect to the individual issuing financial institutions, are utilized in determining individual security valuations. Discount rates were utilized along with the cash flow projections in order to calculate an appropriate fair value. These discount rates were calculated based on industry index rates and adjusted for various credit and liquidity factors. Due to current market conditions as well as the limited trading activity of these securities, the market value of the securities is highly sensitive to assumption changes and market volatility.

**Trading Assets:** The fair values of trading assets are determined by quoted market prices (Level 1 inputs).

**Impaired Loans:** At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value have been partially charged-off or receive specific allocations as part of the allowance for loan losses. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

**Other Real Estate Owned:** Assets acquired through or instead of loan foreclosures are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned (“OREO”) are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Corporation. Once received, appraisals are reviewed for reasonableness of assumptions, approaches utilized, Uniform Standards of Professional Appraisal Practice and other regulatory compliance, as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals are generally completed within the previous 12 month period prior to a property being placed into OREO. On impaired loans, appraisals are adjusted based on the age of the appraisal, the position of the lien, the type of the property and its condition.



Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurement at March 31, 2012 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:	Fair Value			
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 136,695,868	\$ 35,563,500	\$ 99,132,368	\$ -
Mortgage-backed securities, residential	45,957,281	-	45,957,281	-
Obligations of states and political subdivisions	45,542,316	-	45,542,316	-
Collateralized mortgage obligations	6,487,629	-	6,487,629	-
Corporate bonds and notes	13,830,673	-	13,830,673	-
SBA loan pools	1,906,290	-	1,906,290	-
Trust Preferred securities	2,364,804	-	2,018,594	346,210
Corporate stocks	6,665,016	5,975,014	690,002	-
Total available for sale securities	\$ 259,449,877	\$ 43,538,514	\$ 215,565,153	\$ 346,210
Trading assets	\$ 254,243	\$ 254,243	\$ -	\$ -

		Fair Value Measurement at December 31, 2011 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:	Fair Value			
	\$ 152,079,770	\$ 35,950,000	\$ 116,129,770	\$ -

Obligations of U.S. Government and U.S. Government sponsored enterprises				
Mortgage-backed securities, residential	50,766,604	-	50,766,604	-
Obligations of states and political subdivisions	46,512,971	-	46,512,971	-
Trust Preferred securities	2,310,066	-	2,015,156	294,910
Corporate bonds and notes	13,684,199	-	13,684,199	-
Collateralized mortgage obligations	7,536,753	-	7,536,753	-
SBA loan pools	1,949,606	-	1,949,606	-
Corporate stocks	6,029,841	5,339,839	690,002	-
Total available for sale securities	\$280,869,810	\$41,289,839	\$239,285,061	\$294,910
Trading assets	\$294,381	\$294,381	\$-	\$-

There were no transfers between Level 1 and Level 2 during the three-month period ending March 31, 2012 or the year ending December, 31, 2011.

The significant unobservable inputs used in the fair value measurement of the Corporation's collateralized debt obligations are probabilities of specific-issuer defaults and deferrals and specific-issuer recovery assumptions. Significant increases in specific-issuer default assumptions or decreases in specific-issuer recovery assumptions would result in a significantly lower fair value measurement. Conversely, decreases in specific-issuer default assumptions or increases in specific-issuer recovery assumptions would result in a higher fair value measurement. The Corporation treats all interest payment deferrals as defaults and assumes no recoveries on defaults.

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three-month periods ending March 31, 2012 and 2011:

	Fair Value Measurement three-months ended March 31, 2012 Using Significant Unobservable Inputs (Level 3)	Fair Value Measurement three-months ended March 31, 2011 Using Significant Unobservable Inputs (Level 3)
Investment Securities Available for Sale		
Beginning balance	\$ 294,910	\$ 334,585
Total gains/losses (realized/unrealized):		
Included in earnings:		
Income on securities	-	-
Impairment charge on investment securities	-	-
Included in other comprehensive income	51,300	14,450
Transfers in and/or out of Level 3	-	-
Ending balance March 31	\$ 346,210	\$ 349,035

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

		Fair Value Measurement at March 31, 2012 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

Impaired

Loans:

Commercial,  
financial and  
agricultural:

Commercial and industrial	\$	872,053	\$	-	\$	-	\$	872,053
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Commercial

mortgages:

Other		1,161,125		-		-		1,161,125
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Total

Impaired Loans	\$	2,033,178	\$	-	\$	-	\$	2,033,178
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Other real  
estate owned:

Commercial,  
financial and  
agricultural:

Commercial and industrial	\$	218,040	\$	-	\$	-	\$	218,040
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Commercial

mortgages:

Other		366,760		-		-		366,760
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Residential

mortgages

		358,600		-		-		358,600
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Consumer

loans:

Home equity lines & loans		36,600		-		-		36,600
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Total Other

real estate

owned, net

	\$	980,000	\$	-	\$	-	\$	980,000
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		Fair Value Measurement at December 31, 2011 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:	Fair Value			
Impaired Loans:				
Commercial, financial and agricultural:				
Commercial and industrial	\$ 831,601	\$ -	\$ -	\$ 831,601
Commercial mortgages:		-	-	
Other	3,321,838	-	-	3,321,838
Total Impaired Loans	\$ 4,153,439	\$ -	\$ -	\$ 4,153,439
Other real estate owned:				
Commercial, financial and agricultural:				
Commercial and industrial	\$ 218,040	\$ -	\$ -	\$ 218,040
Commercial mortgages:				
Other	366,760	-	-	366,760
Residential mortgages	276,355	-	-	276,355
Consumer loans:				
Home equity lines & loans	36,600	-	-	36,600
Total Other real estate owned, net	\$ 897,755	\$ -	\$ -	\$ 897,755

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$3,838,542 with a valuation allowance of \$1,805,364 as of

March 31, 2012, resulting in no additional provision for loan losses for the three month period ending March 31, 2012. Impaired loans had a carrying amount of \$6,095,645, with a valuation allowance of \$1,942,206 as of December 31, 2011, resulting in a \$958,333 provision for loan losses for the year ending December 31, 2011.

OREO, which is measured by the lower of carrying or fair value less costs to sell, had a net carrying amount of \$980,000 at March 31, 2012. The net carrying amount reflects the outstanding balance of \$1,091,407 net of a valuation allowance of \$111,407 at March 31, 2012 and no write downs resulted for the three-month period ending March 31, 2012. OREO had a net carrying amount of \$897,755 at December 31, 2011. The net carrying amount reflects the outstanding balance of \$1,009,162 net of a valuation allowance of \$111,407 at December 31, 2011, which resulted in write downs of \$12,120 for the year ending December 31, 2011.

The carrying amounts and estimated fair values of other financial instruments, at March 31, 2012 and December 31, 2011, are as follows:

Financial assets:	Carrying Amount	Fair Value Measurements at March 31, 2012 Using			Estimated Fair Value (1)
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash and due from financial institutions	\$ 27,312	\$ 27,312	\$ -	-	\$ 27,312
Interest-bearing deposits in other financial institutions	83,203	80,325	2,878	-	83,203
Trading assets	254	254	-	-	254
Securities available for sale	259,450	43,539	215,565	346	259,450
Securities held to maturity	7,447	-	8,206	-	8,206
Federal Home Loan and Federal Reserve Bank stock	5,436	-	-	-	N/A
Net loans	792,750	-	-	813,736	813,736
Loans held for sale	826	-	826	-	826
Accrued interest receivable	4,382	730	1,315	2,330	4,382
Financial liabilities:					
Deposits:					
Demand, savings, and insured money market accounts	775,741	775,741	-	-	775,741
Time deposits	262,965	-	264,977	-	264,977
	34,998	-	37,621	-	37,621

Securities sold under agreements to repurchase					
Federal Home Loan Bank advances	43,227	-	46,055	-	46,055
Accrued interest payable	676	10	686	-	676
Dividends payable	1,144	1,144	-	-	1,144

## December 31, 2011

	Carrying Amount	Estimated Fair Value (1)
Financial assets:		
Cash and due from financial institutions	\$ 28,205	\$ 28,205
Interest-bearing deposits in other financial institutions	24,697	24,697
Trading assets	294	294
Securities available for sale	280,870	280,870
Securities held to maturity	8,312	9,176
Federal Home Loan and Federal Reserve Bank stock	5,509	N/A
Net loans	787,256	805,760
Loans held for sale	395	395
Accrued interest receivable	3,882	3,882

## Financial liabilities:

## Deposits:

Demand, savings, and insured money market accounts	721,503	721,503
Time deposits	276,990	279,441
Securities sold under agreements to repurchase	37,107	40,019
Federal Home Loan Bank advances	43,344	46,603
Accrued interest payable	800	800

Dividends payable	1,141	1,141
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(1) Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The methods and assumptions used to estimate fair value are described as follows:

#### Cash, Due From and Interest-Bearing Deposits in Other Financial Institutions

For those short-term instruments that generally mature in ninety days or less, the carrying value approximates fair value of which non interest-bearing deposits are classified as Level 1 and interest-bearing deposits with the FHLB and FRB are classified as Level 1, and time deposits are classified as Level 2.

#### FHLB and FRB Stock

It is not practicable to determine the fair value of FHLB and FRB stock due to restrictions on its transferability.

#### Loans Receivable

For variable-rate loans that reprice frequently, fair values approximate carrying values. The fair values for other loans are estimated through discounted cash flow analysis using interest rates currently being offered for loans with similar terms and credit quality. Loans are classified as Level 3. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price. Loans held for sale are classified as Level 2.

#### Deposits

The fair values disclosed for demand deposits, savings accounts and money market accounts are, by definition, equal to the amounts payable on demand at the reporting date (i.e., their carrying values) and classified as Level 1.

The fair value of certificates of deposits is estimated using a discounted cash flow approach that applies interest rates currently being offered on certificates to a schedule of the weighted-average expected monthly maturities and classified as Level 2.

#### Securities Sold Under Agreements to Repurchase (Repurchase Agreements)

These instruments bear both variable and fixed rates of interest. Therefore, the carrying value approximates fair value for the variable rate instruments and the fair value of fixed rate instruments is based on discounted cash flows to maturity. These are classified as Level 2.

#### Federal Home Loan Bank Advances

These instruments bear a stated rate of interest to maturity and, therefore, the fair value is based on discounted cash flows to maturity and classified as Level 2.

#### Accrued Interest Receivable and Payable

For these short-term instruments, the carrying value approximates fair value resulting in a classification of Level 1, Level 2 or Level 3 depending upon the classification of the asset/liability they are associated with.



## 5. Goodwill and Intangible Assets

The changes in goodwill included in the core banking segment during the periods ending March 31, 2012 and 2011 were as follows:

	2012	2011
Beginning of year	\$ 21,983,617	\$ 9,872,375
Adjustment of Acquired goodwill	(159,174)	-
March 31,	\$ 21,824,443	\$ 9,872,375

Acquired intangible assets were as follows at March 31, 2012 and December 31, 2011:

	At March 31, 2012		At December 31, 2011	
	Balance Acquired	Accumulated Amortization	Balance Acquired	Accumulated Amortization
Core deposit intangibles	\$ 3,819,798	\$ 1,373,084	\$ 3,819,798	\$ 1,213,118
Other customer relationship intangibles	6,063,423	2,603,737	6,063,423	2,479,563
Total	\$ 9,883,221	\$ 3,976,821	\$ 9,883,221	\$ 3,692,681

Aggregate amortization expense was \$284,140 and \$176,503 for the three-month periods ended March 31, 2012 and 2011, respectively.

The remaining estimated aggregate amortization expense at March 31, 2012 is listed below:

Year	Estimated Expense
2012	\$ 762,580
2013	876,524
2014	777,801
2015	681,176
2016	607,713
2017 and thereafter	2,200,606
Total	\$ 5,906,400

## 6. Accumulated Other Comprehensive Income

Accumulated other comprehensive income or loss represents the net unrealized holding gains or losses on securities available for sale and the funded status of the Corporation's defined benefit pension plan and other benefit plans, as of the consolidated balance sheet dates, net of the related tax effect.



The following is a summary of the accumulated other comprehensive income balance, net of tax:

	Balance at December 31, 2011	Current Period Change	Balance at March 31, 2012
Unrealized gains on securities available for sale	\$ 7,987,055	\$ 101,526	\$ 8,088,581
Unrealized loss on pension plans and other benefit plans	(9,428,433)	193,768	(9,234,665)
Total	\$ (1,441,378)	\$ 295,294	\$ (1,146,084)

## 7. Commitments and Contingencies

The Corporation is a party to certain financial instruments with off-balance sheet risk such as commitments under standby letters of credit, unused portions of lines of credit, overdraft protection and commitments to fund new loans. In accordance with U.S. GAAP, these financial instruments are not recorded in the financial statements. The Corporation's policy is to record such instruments when funded. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are generally used by the Corporation to manage clients' requests for funding and other client needs.

In the normal course of business, there are various outstanding claims and legal proceedings involving the Corporation or its subsidiaries. On February 14 and April 14, 2011, the Bank received separate settlement demands from representatives of beneficiaries of certain trusts for which the Bank has acted as trustee. The settlement demands relate to alleged claims of, among other things, breach of the Bank's fiduciary duties as trustee, including the Bank's alleged failure to adequately diversify the relevant trust portfolios. The beneficiaries seek aggregate damages of up to approximately \$27.0 million. On September 16, 2011, the beneficiaries objected in the Surrogate's Court of the State of New York, County of Chemung (the "Surrogate's Court") to accountings with respect to the above-mentioned trusts provided by the Bank, based on allegations similar to those offered in the settlement demands. The matter remains pending at the Surrogate Court. Although these matters are inherently unpredictable, management will defend against these claims vigorously. Management has concluded that it is reasonably possible, but not probable, that the financial position, results of operations or cash flows of the Corporation could be materially adversely affected in any particular period by the unfavorable resolution of these claims, notwithstanding any potential recovery under applicable insurance coverage. An amount of loss or range of loss cannot be reasonably estimated at this time.

## 8. Securities

Amortized cost and estimated fair value of securities available for sale are as follows:

	March 31, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 134,096,396	\$ 2,660,433	\$ 60,961	\$ 136,695,868
Mortgage-backed securities, residential	43,370,865	2,586,416	-	45,957,281
Collateralized Mortgage obligations	6,363,526	126,984	2,881	6,487,629
Obligations of states and political subdivisions	43,831,193	1,719,743	8,620	45,542,316
	13,448,409	432,568	50,304	13,830,673

Corporate bonds and notes				
SBA loan pools	1,871,925	34,365	-	1,906,290
Trust Preferred securities	2,540,204	134,035	309,435	2,364,804
Corporate stocks	788,013	5,878,972	1,969	6,665,016
Total	\$ 246,310,531	\$ 13,573,516	\$ 434,170	\$ 259,449,877

	Amortized Cost	December 31, 2011		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 149,140,715	\$ 3,022,726	\$ 83,671	\$ 152,079,770
Mortgage-backed securities, residential	48,129,271	2,637,334	-	50,766,605
Collateralized mortgage obligations	7,412,470	135,603	11,321	7,536,753
Obligations of states and political subdivisions	44,561,789	1,954,265	3,083	46,512,971
Corporate bonds and notes	13,461,675	418,969	196,446	13,684,198
SBA loan pools	1,915,419	34,187	-	1,949,606
Trust preferred securities	2,538,286	132,516	360,735	2,310,066
Corporate stocks	788,030	5,246,655	4,844	6,029,841
Total	\$ 267,947,655	\$ 13,582,255	\$ 660,100	\$ 280,869,810

Amortized cost and estimated fair value of securities held to maturity are as follows:

	Amortized Cost	March 31, 2012		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
Obligations of states and political subdivisions	\$ 7,446,817	\$ 759,655	\$ -	\$ 8,206,472
Total	\$ 7,446,817	\$ 759,655	\$ -	\$ 8,206,472

	Amortized Cost	December 31, 2011		Estimated Fair Value
		Unrealized Gains	Unrealized Losses	
Obligations of states and political subdivisions	\$ 8,311,921	\$ 864,035	\$ -	\$ 9,175,956
Total	\$ 8,311,921	\$ 864,035	\$ -	\$ 9,175,956

The amortized cost and estimated fair value of debt securities are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties:

	March 31, 2012			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within One Year	\$ 40,873,174	\$ 41,400,512	\$ 2,083,170	\$ 2,103,820
After One, But Within Five Years	156,409,760	162,127,467	3,586,148	3,953,357
After Five, But Within Ten Years	44,820,918	46,015,553	1,777,499	2,149,295
After Ten Years	3,418,666	3,241,330	-	-
Total	\$ 245,522,518	\$ 252,784,861	\$ 7,446,817	\$ 8,206,472

Proceeds from sales of securities available for sale that resulted in realized gains were \$ 25,679,688 and \$25,170,898 for the three months ended March 31, 2012 and 2011, respectively. Gross gains of \$297,169 and \$193,398 were realized on these sales during the first quarter of 2012 and 2011, respectively. There were no calls of securities available for sale that resulted in gains for the three months ended March 31, 2012 and 2011. There were no gross losses from calls or sales of securities during the three months ended March 31, 2012 and March 31, 2011.

The following table summarizes the investment securities available for sale and held to maturity with unrealized losses at March 31, 2012 and December 31, 2011 by aggregated major security type and length of time in a continuous unrealized loss position:

March 31, 2012	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 55,431,000	\$ 60,961	\$ -	\$ -	\$ 55,431,000	\$ 60,961
Collateralized mortgage obligations	1,256,943	2,881	-	-	1,256,943	2,881
Obligations of states and political subdivisions	1,059,454	8,620	-	-	1,059,454	8,620
Corporate bonds and notes	992,891	36,123	757,235	14,181	1,750,126	50,304
Trust preferred securities	-	-	346,210	309,435	346,210	309,435
Corporate stocks	-	-	1,669	1,969	1,669	1,969
Total temporarily impaired securities	\$ 58,740,288	\$ 108,585	\$ 1,105,114	\$ 325,585	\$ 59,845,402	\$ 434,170

December 31, 2011	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 27,365,920	\$ 83,671	\$ -	\$ -	\$ 27,365,920	\$ 83,671
Collateralized mortgage obligations	2,546,461	11,321	-	-	2,546,461	11,321

Obligations of states and political subdivisions	947,203	3,083	-	-	947,203	3,083
Corporate bonds and notes	5,261,074	196,446	-	-	5,261,074	196,446
Trust preferred securities	-	-	294,910	360,735	294,910	360,735
Corporate stocks	1,669	1,969	47,117	2,875	48,786	4,844
Total temporarily impaired securities	\$36,122,327	\$296,490	\$342,027	\$363,610	\$36,464,354	\$660,100

## Other-Than-Temporary Impairment

When OTTI occurs, for either debt securities or purchased beneficial interests, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

As of March 31, 2012, the majority of the Corporation's unrealized losses in the investment securities portfolio related to two pooled trust preferred securities. The decline in fair value on these securities is primarily attributable to the financial crisis and resulting credit deterioration and financial condition of the underlying issuers, all of which are financial institutions. This deterioration may affect the future receipt of both principal and interest payments on these securities. This fact combined with the current illiquidity in the market makes it unlikely that the Corporation would be able to recover its investment in these securities if the securities were sold at this time. One of these securities has been previously written down through the income statement to an amount considered to be immaterial to the financial statements. Therefore management is no longer analyzing this security for further impairment.

Our analysis of these investments includes a \$629 thousand book value collateralized debt obligation ("CDO") which is a pooled trust preferred security. This security was rated high quality at inception, but at March 31, 2012 Moody's rated this security as Caa3, which is defined as substantial risk of default. The Corporation uses the OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to determine if there are adverse changes in cash flows during each quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities.

Upon completion of the March 31, 2012 analysis, our model indicated no additional other-than-temporary impairment on the TPREF Funding II security. This security remained classified as available for sale and represented \$300 thousand of the unrealized losses reported at March 31, 2012. Payments continue to be made as agreed on this security.



When conducting the March 31, 2012 analysis, the present value of expected future cash flows using a discount rate equal to the yield in effect at the time of purchase was compared to the previous quarters' analysis. The analysis indicated no further decline in value attributed to credit related factors stemming from further deterioration in the underlying collateral payment streams. Additionally, to estimate fair value the present value of the expected future cash flows was calculated using a current estimated discount rate that a willing market participant might use to value the security based on current market conditions and interest rates. This comparison indicated an increase in value based on factors other than credit which resulted in a gain reported in other comprehensive income. Changes in credit quality may or may not correlate to changes in the overall fair value of the impaired securities as the change in credit quality is only one component in assessing the overall fair value of the impaired securities. Therefore, the recognition of additional credit related OTTI could result in a gain reported in other comprehensive income. Total other-than-temporary impairment recognized in accumulated other comprehensive income was \$188,878 and \$228,598 for securities available for sale at March 31, 2012 and March 31, 2011, respectively.

The table below presents a roll forward of the cumulative credit losses recognized in earnings for the three-month periods ending March 31, 2012 and 2011:

	2012	2011
Beginning balance, January 1,	\$ 3,506,073	\$ 3,438,673
Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized	-	-
Additions/Subtractions:		
Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-
Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	-	-
Ending balance, March 31,	\$ 3,506,073	\$ 3,438,673



## 9. Loans and Allowance for Loan Losses

The composition of the loan portfolio is summarized as follows:

	March 31, 2012	December 31, 2011
Commercial, financial and agricultural	\$ 138,265,330	\$ 142,209,279
Commercial mortgages	276,270,702	264,589,013
Residential mortgages	192,548,256	193,599,853
Indirect consumer loans	96,660,998	97,165,447
Consumer loans	99,287,781	99,351,585
	\$ 803,033,067	\$ 796,915,177

Loans are charged against the allowance for loan losses when management believes that the collectability of all or a portion of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb probable incurred losses on existing loans. Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as the credit risk grade assigned to the loan, historical loan loss experience and review of specific problem loans (including evaluations of the underlying collateral). Historical loss experience is adjusted by management based on their judgment as to the current impact of qualitative factors including changes in the composition and volume of the loan portfolio, overall portfolio quality, and current economic conditions that may affect the borrowers' ability to pay. Management believes that the allowance for loan losses is adequate to absorb probable incurred losses. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

Management, after considering current information and events regarding a borrower's ability to repay its obligations, classifies a loan as impaired when it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.



The general component of the allowance for loan losses covers non-impaired loans and is based on historical loss experience adjusted for current factors. Loans not impaired but classified as substandard and special mention use a historical loss factor on a rolling five year history of net losses. For all other unclassified loans, the historical loss experience is determined by portfolio class and is based on the actual loss history experienced by the Corporation over the most recent two years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio class. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified: commercial, financial and agricultural; commercial mortgages; residential mortgages; and consumer loans.

#### Risk Characteristics

Commercial, financial and agricultural loans primarily consist of loans to small to mid-sized businesses in our market area in a diverse range of industries. These loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value. The credit risk related to commercial loans is largely influenced by general economic conditions and the resulting impact on a borrower's operations or on the value of underlying collateral, if any.

Commercial mortgage loans generally have larger balances and involve a greater degree of risk than residential mortgage loans, inferring higher potential losses on an individual customer basis. Loan repayment is often dependent on the successful operation and management of the properties and/or the businesses occupying the properties, as well as on the collateral securing the loan. Economic events or conditions in the real estate market could have an adverse impact on the cash flows generated by properties securing the Company's commercial real estate loans and on the value of such properties.

Residential mortgage loans are generally made on the basis of the borrower's ability to make repayment from his or her employment and other income, but are secured by real property whose value tends to be more easily ascertainable. Credit risk for these types of loans is generally influenced by general economic conditions, the characteristics of individual borrowers and the nature of the loan collateral.

The consumer loan segment includes home equity lines of credit and home equity loans, which exhibit many of the same risk characteristics as residential mortgages. Indirect and other consumer loans may entail greater credit risk than residential mortgage and home equity loans, particularly in the case of other consumer loans which are unsecured or, in the case of indirect consumer loans, secured by depreciable assets, such as automobiles or boats. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, thus are more likely to be affected by adverse personal circumstances such as job loss, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.



The following tables present activity in the allowance for loan losses by portfolio segment for the three-month periods ending March 31, 2012 and March 31, 2011 and by loans originated by the Corporation (referred to as “Legacy” loans) and loans acquired in the FOFC merger completed on April 8, 2011 (referred to as “Acquired” loans). The Acquired loan allowance represents any valuation allowances established after acquisition for decreases in cash flows expected to be collected on loans acquired with deteriorated credit quality:

Legacy Loans	Three Months Ended March 31, 2012					
	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Allowance for loan losses						
Beginning balance:	\$ 3,143,373	\$ 2,570,149	\$ 1,309,649	\$ 2,192,729	\$ 443,420	\$ 9,659,320
Charge Offs:	-	-	(14,340)	(158,319)	-	(172,659)
Recoveries:	172,603	10,235	-	61,983	-	244,821
Net charge offs	172,603	10,235	(14,340)	(96,336)	-	72,162
Provision	(179,519)	373,248	121,943	4,040	(69,712)	250,000
Ending balance	\$ 3,136,457	\$ 2,953,632	\$ 1,417,252	\$ 2,100,433	\$ 373,708	\$ 9,981,482

Acquired loans	Three Months Ended March 31, 2012					
	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Allowance for loan losses						
Beginning balance:	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Reclassification of acquired loan discount	73,228	50,332	-	-	-	123,560
Charge Offs:	-	(49,057)	-	-	-	(49,057)
Recoveries:	-	-	-	-	-	-
Net charge offs	-	(49,057)	-	-	-	(49,057)
Provision	151,708	75,597	-	-	-	227,305
Ending balance	\$ 224,936	\$ 76,872	\$ -	\$ -	\$ -	\$ 301,807

Allowance for loan losses	Three Months Ended March 31, 2011					Total
	Commercial, Financial and	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	

Agricultural						
Beginning						
balance:	\$ 2,118,299	\$ 2,575,058	\$ 1,301,780	\$ 2,727,022	\$ 775,972	\$ 9,498,131
Charge						
Offs:	-	(3,764)	-	(206,911)	-	(210,675)
Recoveries:	110,589	9,629	14,479	43,797	-	178,494
Net						
charge offs	110,589	5,865	14,479	(163,114)	-	(32,181)
Provision	273,312	76,262	49,955	(139,596)	(134,933)	125,000
Ending						
balance	\$ 2,572,200	\$ 2,657,185	\$ 1,366,214	\$ 2,424,312	\$ 641,040	\$ 9,590,951



The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment based on impairment method as of March 31, 2012 and December 31, 2011. The recorded investment excludes loans acquired in the FOFC merger except those loans acquired with deteriorated credit quality:

## March 31, 2012

Allowance for loan losses	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 1,492,310	\$ 313,054	\$ -	\$ -	\$ -	\$ 1,805,364
Collectively evaluated for impairment	1,644,147	2,640,578	1,417,252	2,100,433	373,708	8,176,118
Acquired with deteriorated credit quality	224,936	76,871	-	-	-	301,807
Total ending allowance balance	\$ 3,361,393	\$ 3,030,503	\$ 1,417,252	\$ 2,100,433	\$ 373,708	\$ 10,283,289

## December 31, 2011

Allowance for loan losses	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	\$ 1,528,651	\$ 413,555	\$ -	\$ -	\$ -	\$ 1,942,206
Collectively evaluated for impairment	1,614,722	2,156,594	1,309,649	2,192,729	443,420	7,717,114
Total ending allowance balance	\$ 3,143,373	\$ 2,570,149	\$ 1,309,649	\$ 2,192,729	\$ 443,420	\$ 9,659,320

March 31, 2012

Loans:	Commercial, Financial and Agricultural	Commercial Mortgages
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