

CCFNB BANCORP INC  
Form 10-Q  
November 13, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013.

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_ .

No. 000-19028  
(Commission file number)

CCFNB BANCORP, INC.  
(Exact name of registrant as specified in its charter)

PENNSYLVANIA  
(State or other jurisdiction of  
incorporation or organization)

23-2254643  
(I.R.S. Employer  
Identification Number)

232 East Street, Bloomsburg, PA  
(Address of principal executive offices)

17815  
(Zip Code)

Registrant's telephone number, including area code:

(570) 784-4400

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 the definitions of "larger accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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Non-accelerated filer

(Do not check if a smaller reporting company)

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

On November 1, 2013, there were 2,180,204 shares of the Registrant's common stock outstanding, par value \$1.25.

**CCFNB Bancorp, Inc. and Subsidiary  
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**PART I Financial Information****Item 1. Financial Statements****CCFNB Bancorp, Inc.  
Consolidated Balance Sheets**

(In Thousands)	(Unaudited) September 30, 2013	December 31, 2012
<b>ASSETS</b>		
Cash and due from banks	\$ 12,412	\$ 10,391
Interest-bearing deposits in other banks	472	10,146
Federal funds sold	599	2,054
Total cash and cash equivalents	13,483	22,591
Investment securities, available for sale, at fair value	181,664	170,444
Restricted securities, at cost	4,056	3,355
Loans held for sale	12,106	10,824
Loans, net of unearned income	385,118	363,941
Less: Allowance for loan losses	6,128	6,186
Loans, net	378,990	357,755
Premises and equipment, net	11,604	11,935
Accrued interest receivable	1,606	1,592
Cash surrender value of bank-owned life insurance	15,392	14,975
Investment in limited partnerships	1,254	1,413
Intangible Assets:		
Core deposit	927	1,203
Goodwill	7,937	7,937
Prepaid FDIC assessment	-	864
Other assets	4,012	2,833
<b>TOTAL ASSETS</b>	<b>\$ 633,031</b>	<b>\$ 607,721</b>
<b>LIABILITIES</b>		
Interest-bearing deposits	\$ 381,798	\$ 382,133
Noninterest-bearing deposits	77,461	80,895
Total deposits	459,259	463,028
Short-term borrowings	93,159	64,026
Long-term borrowings	2,108	4,112
Accrued interest payable	275	333
Other liabilities	3,459	1,686
<b>TOTAL LIABILITIES</b>	<b>558,260</b>	<b>533,185</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$1.25 per share; authorized 15,000,000 shares, issued 2,326,904 shares in 2013; and 2,315,646 shares in 2012	2,909	2,894
Surplus	29,336	28,931
Retained earnings	47,362	44,713
Accumulated other comprehensive income	(163)	2,046
	(4,673)	(4,048)

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Treasury stock, at cost; 146,700 shares in 2013 and 129,900 shares in 2012

TOTAL STOCKHOLDERS' EQUITY	74,771	74,536
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 633,031	\$ 607,721

See accompanying notes to unaudited consolidated financial statements.

**CCFNB Bancorp, Inc.**  
**Consolidated Statements of Income**  
**(Unaudited)**

(In Thousands, Except Per Share Data)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
<b>INTEREST AND DIVIDEND INCOME</b>				
Interest and fees on loans:				
Taxable	\$ 4,178	\$ 4,348	\$ 12,294	\$ 12,925
Tax-exempt	273	279	803	835
Interest and dividends on investment securities:				
Taxable	494	825	1,673	2,849
Tax-exempt	207	178	589	517
Dividend and other interest income	26	17	66	48
Federal funds sold	-	-	1	1
Deposits in other banks	2	19	24	44
<b>TOTAL INTEREST AND DIVIDEND INCOME</b>	<b>5,180</b>	<b>5,666</b>	<b>15,450</b>	<b>17,219</b>
<b>INTEREST EXPENSE</b>				
Deposits	542	754	1,692	2,447
Short-term borrowings	53	45	146	164
Long-term borrowings	17	31	72	107
<b>TOTAL INTEREST EXPENSE</b>	<b>612</b>	<b>830</b>	<b>1,910</b>	<b>2,718</b>
<b>NET INTEREST INCOME</b>	<b>4,568</b>	<b>4,836</b>	<b>13,540</b>	<b>14,501</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>30</b>	<b>305</b>	<b>90</b>	<b>365</b>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>4,538</b>	<b>4,531</b>	<b>13,450</b>	<b>14,136</b>
<b>NON-INTEREST INCOME</b>				
Service charges and fees	353	371	1,008	1,110
Gain on sale of loans	201	468	871	1,208
Earnings on bank-owned life insurance	120	122	359	381
Brokerage	113	106	349	331
Trust	147	167	433	467
Investment security gains (losses)	65	-	65	(17)
Interchange fees	289	267	829	783
Other	197	277	653	811
<b>TOTAL NON-INTEREST INCOME</b>	<b>1,485</b>	<b>1,778</b>	<b>4,567</b>	<b>5,074</b>
<b>NON-INTEREST EXPENSE</b>				
Salaries	1,607	1,638	4,873	4,882
Employee benefits	518	406	1,607	1,479
Occupancy	271	265	838	783
Furniture and equipment	279	274	852	865

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State shares tax	168	160	502	485
Professional fees	148	161	476	488
Director's fees	66	65	199	192
FDIC assessments	78	80	236	239
Telecommunications	68	58	200	185
Amortization of core deposit intangible	92	108	276	326
Automated teller machine and interchange	128	132	356	498
Other	397	625	1,237	1,513
TOTAL NON-INTEREST EXPENSE	3,820	3,972	11,652	11,935
INCOME BEFORE INCOME TAX PROVISION	2,203	2,337	6,365	7,275
INCOME TAX PROVISION	523	573	1,514	1,814
NET INCOME	\$ 1,680	\$ 1,764	\$ 4,851	\$ 5,461
EARNINGS PER SHARE	\$ 0.77	\$ 0.80	\$ 2.22	\$ 2.48
CASH DIVIDENDS PER SHARE	\$ 0.34	\$ 0.33	\$ 1.01	\$ 0.97
WEIGHTED AVERAGE SHARES OUTSTANDING	2,178,274	2,197,306	2,181,733	2,202,034

See accompanying notes to the unaudited consolidated financial statements.

**CCFNB Bancorp, Inc.**  
**Consolidated Statements of Changes in Stockholders' Equity**  
**(Unaudited)**

(In Thousands Except Per Share Data)	Common Stock Shares	Amount	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2011	2,300,987	\$ 2,876	\$ 28,421	\$ 40,418	\$ 2,260	\$ (2,560)	\$ 71,415
Comprehensive Income:							
Net income				5,461			5,461
Change in net unrealized gain on investment securities available-for-sale, net of reclassification adjustment and tax effects.					209		209
Common stock issuance under dividend reinvestment and stock purchase plans	10,894	14	372				386
Recognition of employee stock purchase plan expense			4				4
Purchase of treasury stock (25,500 shares)						(919)	(919)
Cash dividends, (\$0.97 per share)				(2,134)			(2,134)
Balance, September 30, 2012	2,311,881	\$ 2,890	\$ 28,797	\$ 43,745	\$ 2,469	\$ (3,479)	\$ 74,422
Balance, December 31, 2012	2,315,646	\$ 2,894	\$ 28,931	\$ 44,713	\$ 2,046	\$ (4,048)	\$ 74,536
Comprehensive Income:							
Net income				4,851			4,851
Change in net unrealized loss on investment securities available-for-sale, net of reclassification adjustment and tax effects.					(2,209)		(2,209)
Common stock issuance under dividend reinvestment and stock purchase plans	11,258	15	400				415
Recognition of employee stock purchase plan expense			5				5
Purchase of treasury stock (16,800 shares)						(625)	(625)
Cash dividends, (\$1.01 per share)				(2,202)			(2,202)
Balance, September 30, 2013	2,326,904	\$ 2,909	\$ 29,336	\$ 47,362	\$ (163)	\$ (4,673)	\$ 74,771

See accompanying notes to the unaudited consolidated financial statements.

**CCFNB Bancorp, Inc.**  
**Consolidated Statements of Comprehensive Income**  
**(Unaudited)**

(In Thousands)	For The Nine Months Ended September 30,	
	2013	2012
Net Income	\$ 4,851	\$ 5,461
Other comprehensive income:		



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Change in unrealized gain on investment securities available-for-sale	(3,412)		333	
Realized gain (loss) included in net income	65		(17)	
Other comprehensive loss before tax expense	(3,347)		316	
Tax effect	(1,138)		107	
Other comprehensive loss		(2,209)		209
Comprehensive income		\$ 2,642		\$ 5,670

See accompanying notes to the consolidated financial statements.

**CCFNB Bancorp, Inc.**  
**Consolidated Statements of Cash Flows**  
**(Unaudited)**

(In Thousands)	For The Nine Months Ended September 30,	
	2013	2012
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 4,851	\$ 5,461
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	90	365
Depreciation and amortization of premises and equipment	529	544
Amortization and accretion on investment securities	1,001	634
Impairment loss on securities	-	17
Deferred income taxes	(146)	(262)
Gain on sale of investment securities	(65)	-
Gain on sale of loans	(871)	(1,208)
Proceeds from sale of mortgage loans	30,196	34,248
Originations of mortgage loans held for resale	(30,607)	(31,639)
Loss on sale of other real estate	14	-
Amortization of intangibles and investment in limited partnerships	435	494
Decrease in accrued interest receivable	(14)	(450)
Increase in cash surrender value of bank-owned life insurance	(417)	(439)
Decrease in accrued interest payable	(58)	(127)
Other, net	1,299	96
Net cash provided by operating activities	6,237	7,734
<b>INVESTING ACTIVITIES</b>		
Investment securities available for sale:		
Purchases	(60,665)	(98,814)
Proceeds from sales, maturities and redemptions	46,622	104,688
Proceeds from redemption of restricted securities	28	58
Purchase of restricted securities	(729)	(380)
Net increase in loans	(21,396)	(11,557)
Proceeds from sale of other real estate owned	45	98
Acquisition of premises and equipment	(198)	(847)
Net cash used in investing activities	(36,293)	(6,754)
<b>FINANCING ACTIVITIES</b>		
Net (decrease) increase in deposits	(3,769)	7,281
Net increase in short-term borrowings	29,133	14,530
Repayment of long-term borrowings	(2,004)	(2,004)
Acquisition of treasury stock	(625)	(919)
Proceeds from issuance of common stock	415	386
Cash dividends paid	(2,202)	(2,134)
Net cash provided by financing activities	20,948	17,140
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(9,108)</b>	<b>18,120</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>22,591</b>	<b>38,176</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 13,483</b>	<b>\$ 56,296</b>

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION**

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Interest paid	\$	1,968	\$	2,845
Income taxes paid		1,452		2,120
Securities acquired but not settled		1,460		891
Loans transferred to other real estate owned		71		160

See accompanying notes to the unaudited consolidated financial statements.

**CCFNB BANCORP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting and reporting policies of CCFNB Bancorp, Inc. (the "Corporation") are in accordance with the accounting principles generally accepted in the United States of America and conform to common practices within the banking industry. The more significant policies follow:

**PRINCIPLES OF CONSOLIDATION**

The consolidated financial statements include the accounts of CCFNB Bancorp, Inc. and its wholly-owned subsidiary, First Columbia Bank & Trust Co. (the "Bank"). Columbia Financial Corporation ("CFC"), the former parent company of the Bank was acquired by CCFNB Bancorp, Inc. on July 18, 2008 and Columbia County Farmers National Bank ("CCFNB") merged with and into the Bank on July 18, 2008. All significant inter-company balances and transactions have been eliminated in consolidation.

During 2011, the Bank sold its Hazleton Branch office to another financial institution. The sale resulted in the disposition of the Hazleton branch building, equipment, and cash. The sale also included the purchaser's assumption of all deposits associated with the Hazleton office which amounted to approximately \$17.7 million. There were no loans sold as part of this transaction. The sale of this office was completed on June 24, 2011.

**NATURE OF OPERATIONS**

The Corporation is a financial holding company that provides full service banking, including trust services, through the Bank, to individuals and corporate customers. The Bank has thirteen offices covering an area of approximately 752 square miles in North Central Pennsylvania. The Corporation and Bank are subject to the regulation of the Pennsylvania Department of Banking, the Federal Deposit Insurance Corporation, and the Federal Reserve Bank of Philadelphia.

Procuring deposits and making loans are the major lines of business. The deposits are mainly deposits of individuals and small businesses and include various types of checking accounts, statement savings, money market accounts, interest checking accounts, individual retirement accounts, and certificates of deposit. The Bank also offers non-insured "Repo sweep" accounts. Lending products include commercial, consumer, and mortgage loans. The trust services, trading under the name of B.B.C.T., Co. include administration of various estates, pension plans, self-directed IRA's and other services. A third-party brokerage arrangement is also resident in the Lightstreet branch. This investment center offers a full line of stocks, bonds and other non-insured financial services.

**SEGMENT REPORTING**

The Bank acts as an independent community financial services provider, and offers traditional banking and related financial services to individual, business and government customers. Through its branch, remote capture, internet and mobile banking, telephone and automated teller machine network, the Bank offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer and mortgage loans; and the providing of other financial services. The Bank also performs personal, corporate, pension and fiduciary services through its B.B.C.T., Co. as well as offers diverse investment products through its investment center.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial, retail, trust and investment center operations of the Corporation. As such, discrete financial information is not available and segment reporting would not be meaningful.

**USE OF ESTIMATES**

The preparation of these consolidated financial statements in conformity with accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of these consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ

significantly from those estimates. Material estimates that are particularly susceptible to significant changes include the assessment for impairment of certain investment securities, the allowance for loan losses, deferred tax assets and liabilities, impairment of other intangible assets, and other real estate owned. Assumptions and factors used in the estimates are evaluated on an annual basis or whenever events or changes in circumstances indicate that the previous assumptions and factors have changed. The result of the analysis could result in adjustments to the estimates.

#### **INVESTMENT SECURITIES**

The Corporation classifies its investment securities as either "held-to-maturity" or "available-for-sale" at the time of purchase. Debt securities are classified as held-to-maturity when the Corporation has the ability and positive intent to hold the securities to maturity. Investment securities held-to-maturity are carried at cost adjusted for amortization of premiums and accretion of discounts to maturity.

Debt securities not classified as held-to-maturity and equity securities included in the available-for-sale category are carried at fair value, and the amount of any unrealized gain or loss net of the effect of deferred income taxes is reported as other comprehensive income in the Consolidated Statement of Changes in Stockholders' Equity. Management's decision to sell available-for-sale securities is based on changes in economic conditions controlling the sources and uses of funds, terms, availability of and yield of alternative investments, interest rate risk, and the need for liquidity.

The cost of debt securities classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion, as well as interest and dividends, is included in interest income from investments. Realized gains and losses are included in net investment securities gains. The cost of investment securities sold, redeemed or matured is based on the specific identification method.

### **RESTRICTED SECURITIES**

Restricted equity securities consist of stock in the Federal Home Loan Bank of Pittsburgh ("FHLB Pittsburgh"), and Atlantic Central Bankers Bank ("ACBB") and do not have a readily determinable fair value because their ownership is restricted, and they can be sold back only to the FHLB-Pittsburgh, ACBB or to another member institution.

Therefore, these securities are classified as restricted equity investment securities, carried at cost, and evaluated for impairment. At September 30, 2013, the Corporation held \$4,021,000 in stock of the FHLB-Pittsburgh and \$35,000 in stock of ACBB. At December 31, 2012, the Corporation held \$3,320,000 in stock of FHLB-Pittsburgh and \$35,000 in stock of ACBB.

The Corporation evaluated its holding of restricted stock for impairment and deemed the stock to not be impaired due to the expected recoverability of par value, which equals the value reflected within the Corporation's financial statements. The decision was based on several items ranging from the estimated true economic losses embedded within FHLB's mortgage portfolio to the FHLB's liquidity position and credit rating. The Corporation utilizes the impairment framework outlined in GAAP to evaluate stock for impairment. The following factors were evaluated to determine the ultimate recoverability of the par value of the Corporation's restricted stock holdings; (i) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted; (ii) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (iii) the impact of legislative and regulatory changes on the institutions and, accordingly, on the customer base of the FHLB; (iv) the liquidity position of the FHLB; and (v) whether a decline is temporary or whether it affects the ultimate recoverability of the FHLB stock based on (a) the materiality of the carrying amount to the member institution and (b) whether an assessment of the institution's operational needs for the foreseeable future allow management to dispose of the stock. Based on the analysis of these factors, the Corporation determined that its holding of restricted stock was not impaired at September 30, 2013 and December 31, 2012.

### **LOANS**

Loans are stated at their outstanding principal balances, net of deferred fees or costs, unearned income, and the allowance for loan losses. Interest on loans is accrued on the principal amount outstanding, primarily on an actual day basis. Non-refundable loan fees and certain direct costs are deferred and amortized over the life of the loans using the interest method. The amortization is reflected as an interest yield adjustment, and the deferred portion of the net fees and costs is reflected as a part of the loan balance.

Real estate mortgage loans held for resale are carried at the lower of cost or market on an aggregate basis. A portion of these loans are sold with limited recourse by the Corporation.

Generally, a loan is classified as non-accrual, with the accrual of interest on such a loan discontinued when the contractual payment of principal or interest has become 90-days past due or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well-secured. When a loan is placed on non-accrual status, unpaid interest credited to income in the current year is reversed, and unpaid interest accrued in prior years is charged against the allowance for loan losses. Certain non-accrual loans may continue to perform wherein payments are still being received with those payments generally applied to principal. Non-accrual loans

remain under constant scrutiny and if performance continues, interest income may be recorded on a cash basis based on management's judgment as to collectability of principal.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Under current accounting standards, the allowance for loan losses related to impaired loans is based on discounted cash flows using the loan's effective interest rate or the fair value of the collateral for certain collateral dependent loans. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above.

#### **ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is maintained at a level established by management to be adequate to absorb estimated potential loan losses. Management's periodic evaluation of the adequacy of the allowance for loan losses is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change.

In addition, the Bank is subject to periodic examination by its federal and state examiners, and may be required by such regulators to recognize additions to the allowance for loan losses based on their assessment of credit information available to them at the time of their examinations.

In addition, an allowance is provided for possible credit losses on off-balance sheet credit exposures. The allowance is estimated by management and is classified in other liabilities.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. At the present time, select loans are not aggregated for collective impairment evaluation, as such; all loans are subject to individual impairment evaluation should the facts and circumstances pertinent to a particular loan suggest that such evaluation is necessary. Factors considered by management in determining impairment include payment status and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. 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 collateral. 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 trouble 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 Bank determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers all other loans not identified as impaired and is based on historical losses adjusted for current factors. The historical loss component of the allowance is determined by losses recognized by portfolio segment over the preceding two years. In calculating the historical component of our allowance, we aggregate our loans into one of four portfolio segments: Commercial, Financial & Agriculture, Commercial Real Estate, Consumer Real Estate, and Installment Loans to Individuals. Risk factors impacting loans in each of the portfolio segments include broad deterioration of property values, reduced consumer and business spending as a result of continued high unemployment and reduced credit availability and lack of confidence in a sustainable recovery. Actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: the concentration of watch and substandard loans as a percentage of total loans, levels of loan concentration within the portfolio segment or division of a portfolio segment and broad economic conditions.

## **PREMISES AND EQUIPMENT**

Premises and equipment are stated at cost less accumulated depreciation computed principally on the straight-line method over the estimated useful lives of the assets. Maintenance and minor repairs are charged to operations as incurred. The cost and accumulated depreciation of the premises and equipment retired or sold are eliminated from the property accounts at the time of retirement or sale, and the resulting gain or loss is reflected in current operations.

## **MORTGAGE SERVICING RIGHTS**

The Bank originates and sells real estate loans to investors in the secondary mortgage market. After the sale, the Bank retains the right to service most of these loans. When originated mortgage loans are sold and servicing is retained, a servicing asset is capitalized based on relative fair value at the date of sale. Servicing assets are amortized as an offset to other fees in proportion to, and over the period of, estimated net servicing income. The unamortized cost is included in other assets in the accompanying consolidated balance sheets. The servicing rights are periodically evaluated for impairment based on their relative fair value.



## **INTANGIBLE ASSETS - GOODWILL**

Goodwill represents the excess of the purchase price over the fair market value of net assets acquired. The Corporation has recorded net goodwill of \$7,937,000 at September 30, 2013 and December 31, 2012 related to the 2008 acquisition of Columbia Financial Corporation and its subsidiary, First Columbia Bank & Trust Co. In accordance with current accounting standards, goodwill is not amortized. Management performs an annual evaluation for impairment. Any impairment of goodwill results in a charge to income. The Corporation periodically assesses whether events or changes in circumstances indicate that the carrying amounts of goodwill and other intangible assets may be impaired. Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The Company employs general industry practices in evaluating the impairment of its goodwill and other intangible assets. The Company calculates the value of goodwill using a combination of the following valuation methods: dividend discount analysis under the income approach, which calculates the present value of all excess cash flows plus the present value of a terminal value, the price/earnings multiple under the market approach and the change in control premium to market price approach. Based upon these reviews, management determined there was no impairment of goodwill during 2013 or 2012. No assurance can be given that future impairment tests will not result in a charge to earnings.

**INTANGIBLE ASSETS CORE DEPOSIT**

The Corporation has an amortizable intangible asset related to the deposit premium paid for the acquisition of Columbia Financial Corporation's subsidiary, First Columbia Bank & Trust Co. This intangible asset is being amortized on a sum of the years digits method over 10 years and has a carrying value of \$927,000 as of September 30, 2013. At December 31, 2012, the intangible asset had a carrying value of \$1,203,000. The recoverability of the carrying value is evaluated on an ongoing basis, and permanent declines in value, if any, are charged to expense. Amortization of the core deposit intangible amounted to \$276,000 and \$326,000 for the nine months ended September 30, 2013 and 2012, respectively.

The estimated amortization expense of the core deposit intangible over its remaining life is as follows:

For the Year Ended:

Remainder of 2013	\$92,000
2014	301,000
2015	234,000
2016	166,000
2017	99,000
Thereafter	35,000
Total	\$927,000

**OTHER REAL ESTATE OWNED**

Real estate properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value on the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell and is included in other assets. Revenues derived from and costs to maintain the assets and subsequent gains and losses on sales are included in other non-interest income and expense. Other real estate owned amounted to \$12,000 as of September 30, 2013 and \$0 as of December 31, 2012.

**BANK OWNED LIFE INSURANCE**

The Corporation invests in Bank Owned Life Insurance (BOLI). Purchase of BOLI provides life insurance coverage on certain present and retired employees and Directors with the Bank being owner and primary beneficiary of the policies.

**INVESTMENTS IN LIMITED PARTNERSHIPS**

The Corporation is a limited partner in four partnerships at September 30, 2013 that provide low income housing in the Corporation's geographic market area. The investments are accounted for under the effective yield method. Under the effective yield method, the Corporation recognizes tax credits as they are allocated and amortizes the initial cost of the investment to provide a constant effective yield over the period that the tax credits are allocated to the Corporation. Under this method, the tax credits allocated, net of any amortization of the investment in the limited partnerships, are recognized in the consolidated statements of income as a component of income tax expense. The amount of tax credits allocated to the Corporation was \$269,000 and the amortization of the investments in limited partnerships was \$159,000 and \$167,000 for the nine months ended September 30, 2013 and 2012, respectively. The carrying value of the Corporation's investments in limited partnerships was \$1,254,000 at September 30, 2013 and \$1,413,000 at December 31, 2012.

**INCOME TAXES**

The provision for income taxes is based on the results of operations, adjusted primarily for tax-exempt income. Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. Deferred tax assets and liabilities are determined based on the differences between the consolidated financial statement and income tax basis of assets and liabilities measured by using the enacted tax rates and laws expected to be in effect when the timing differences are expected to reverse. Deferred tax expense or benefit is based on the

difference between deferred tax asset or liability from period to period.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, the projected future taxable income and tax planning strategies in making this assessment. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Corporation and the Bank are subject to U.S. federal income tax and Commonwealth of Pennsylvania tax. The Corporation is no longer subject to examination by Federal or State taxing authorities for the years before 2007. At September 30, 2013 and December 31, 2012 the Corporation did not have any unrecognized tax benefits. The Corporation does not expect the amount of any unrecognized tax benefits to significantly increase in the next twelve months. The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other noninterest expense. At September 30, 2013 and December 31, 2012, the Corporation did not have any amounts accrued for interest and/or penalties.

### **PER SHARE DATA**

Basic earnings per share are calculated by dividing net income by the weighted average number of shares of common stock outstanding at the end of each period. Diluted earnings per share are calculated by increasing the denominator for the assumed conversion of all potentially dilutive securities. The Corporation does not have any securities which have or will have a dilutive effect, so accordingly, basic and diluted per share data are the same.

### **CASH FLOW INFORMATION**

For purposes of reporting consolidated cash flows, cash and cash equivalents include cash on hand and due from banks, interest-bearing deposits in other banks and federal funds sold. The Corporation considers cash classified as interest-bearing deposits with other banks as a cash equivalent because they are represented by cash accounts essentially on a demand basis. Federal funds are also included as a cash equivalent because they are generally purchased and sold for one-day periods.

### **TREASURY STOCK**

The purchase of the Corporation's common stock is recorded at cost. At the date of subsequent reissue, the treasury stock account is reduced by the cost of such stock on a last-in first-out basis.

### **TRUST ASSETS AND INCOME**

Property held by the Corporation in a fiduciary or agency capacity for its customers is not included in the accompanying consolidated financial statements because such items are not assets of the Corporation and the Bank. Trust Department income is generally recognized on a cash basis and is not materially different than if it was reported on an accrual basis.

### **ADVERTISING COSTS**

It is the Corporation's policy to expense advertising costs in the period in which they are incurred. Advertising expense for the nine months ended September 30, 2013 and 2012 was approximately \$157,000 and \$179,000, respectively.

### **RECENT ACCOUNTING PRONOUNCEMENTS**

In April 2011, the FASB issued guidance within the ASU 2011-02 "A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring." ASU 2011-02 clarifies when a loan modification restructuring is considered a troubled debt restructuring. The adoption of this guidance did not have a material impact on the Corporation's consolidated statement of income (loss), its consolidated balance sheet, or its consolidated statement of cash flows.

In April 2011, the FASB issued guidance within the ASU 2011-04, "Amendments to Achieve Common Fair Value measurement and Disclosure Requirements in U.S. GAAP and IFRSs". This ASU amends existing guidance regarding the highest and best use and valuation assumption by clarifying these concepts are only applicable to measuring the fair value of nonfinancial assets. The ASU also clarifies that the fair value measurement of financial assets and financial liabilities which have offsetting market risks or counterparty credit risks that are managed on a portfolio basis, when several criteria are met, can be measured at the net risk position. Additional disclosures about Level 3 fair value measurements are required including a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, a description of the valuation process in place, and discussion of the sensitivity of fair value changes in unobservable inputs and interrelationships about those inputs as well as disclosure of the level of the fair value of items that are not measured at fair value in the financial statements but disclosure of fair value if required. ASU 2011-04 was effective for the Corporation's reporting period beginning after December 15, 2011, and was applied prospectively. The Corporation has adopted this guidance and the adoption of this guidance did not have any impact on the Corporation's consolidated statement of income, its consolidated balance sheet or its consolidated statement of cash flows.

In June 2011, the FASB issued guidance within ASU 2011-05, "Presentation of Comprehensive Income". This ASU amends current guidance to allow a company the option of presenting the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments do not change the option for a company to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense (benefit) related to the total of other comprehensive income items. The amendments do not affect how earnings per share is calculated or presented. The provisions of ASU 2011-05 are effective for the Corporation's reporting period beginning after December 15, 2011, and was applied retrospectively. The Corporation has adopted this guidance and the adoption of this guidance did not have any impact on the Corporation's consolidated statement of income (loss), its consolidated balance sheet, or its consolidated statements of cash flows.

In September 2011, the FASB issued an update ASU 2011-08, "Testing Goodwill for Impairment", to simplify the current two-step goodwill impairment test in FASB ASC Topic 350-20, "Intangibles - Goodwill and Other: Goodwill". This update permits entities to first perform a qualitative assessment to determine whether it is more likely than not (likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. If the entity determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it would then perform the first step of the goodwill impairment test; otherwise, no further impairment test would be required. This guidance is effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Corporation has adopted this guidance and the adoption of this guidance did not have any impact on its consolidated financial statements.

**RECLASSIFICATIONS**

Certain amounts in the consolidated financial statements of the prior periods have been reclassified to conform to presentations used in the 2013 consolidated financial statements. Such reclassifications had no effect on the Corporation's consolidated financial condition or net income.

**2. INVESTMENT SECURITIES AVAILABLE-FOR-SALE**

The amortized cost, related estimated fair value, and unrealized gains and losses for investment securities were as follows at September 30, 2013 and December 31, 2012:

(In Thousands)	September 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligation of U.S. Government Corporations and Agencies:				
Mortgage-backed	\$ 97,228	\$ 1,167	\$ (1,078)	\$ 97,317
Other	47,710	84	(786)	47,008
Obligations of state and political subdivisions	34,910	369	(484)	34,795
Total debt securities	179,848	1,620	(2,348)	179,120
Marketable equity securities	2,062	558	(76)	2,544
Total investment securities AFS	\$ 181,910	\$ 2,178	\$ (2,424)	\$ 181,664

(In Thousands)	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligation of U.S. Government Corporations and Agencies:				
Mortgage-backed	\$ 98,938	\$ 2,121	\$ (82)	\$ 100,977
Other	40,000	193	(25)	40,168
Obligations of state and political subdivisions	26,422	785	(12)	27,195
Total debt securities	165,360	3,099	(119)	168,340
Marketable equity securities	1,983	299	(178)	2,104
Total investment securities AFS	\$ 167,343	\$ 3,398	\$ (297)	\$ 170,444

Securities available-for-sale with an aggregate fair value of \$139,169,000 and \$110,103,000 at September 30, 2013 and December 31, 2012, respectively, were pledged to secure public funds, trust funds, securities sold under agreements to repurchase and other balances of \$117,412,000 and \$88,508,000 at September 30, 2013 and December 31, 2012, respectively, as required by law.

The amortized cost and estimated fair value of investment securities, by expected maturity, are shown below at September 30, 2013. Expected maturities on debt securities will differ from contractual maturities, because some borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Other securities and marketable equity securities are not considered to have defined maturities and are included in the "Due after ten years" category:

Weighted

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(In Thousands)	Amortized Cost	Estimated Fair Value	Average Yield	
Due in one year or less	\$ 3,835	\$ 3,849	1.66	%
Due after one year to five years	32,257	32,159	1.33	%
Due after five years to ten years	47,117	46,741	2.40	%
Due after ten years	96,639	96,371	1.38	%
Total	\$ 179,848	\$ 179,120		

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There were no aggregate investments with a single issuer (excluding the U. S. Government and its Agencies) which exceeded ten percent of consolidated stockholders' equity at September 30, 2013 or December 31, 2012. The quality rating of all obligations of state and political subdivisions were "A" or higher, as rated by Moody's or Standard and Poors. The only exceptions were local issues which were not rated, but were secured by the full faith and credit obligations of the communities that issued these securities. All of the state and political subdivision investments were actively traded in a liquid market.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under FASB ASC 320 (SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities). In determining OTTI under the FASB ASC 320 (SFAS No. 115) model, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When other-than-temporary-impairment occurs, the amount of the other-than-temporary-impairment 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 other-than-temporary impairment 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 other-than-temporary impairment shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary impairment 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 other-than-temporary- impairment related to the other factors shall be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the other-than-temporary-impairment recognized in earnings shall become the new amortized cost basis of the investment.

The following summary shows the gross unrealized losses and fair value, aggregated by investment category of those individual securities that have been in a continuous unrealized loss position for less than or more than 12 months as of September 30, 2013 and December 31, 2012:

(In Thousands)	September 30, 2013					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Obligations of U.S. Government Corporations and Agencies:						
Mortgage-backed	\$ 53,275	\$ 983	\$ 4,470	\$ 95	\$ 57,745	\$ 1,078
Other	30,210	786	-	-	30,210	786
Obligations of state and political subdivisions	14,110	476	818	8	14,928	484



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Total debt securities	97,595	2,245	5,288	103	102,883	2,348
Equity securities	185	4	285	72	470	76
Total	\$ 97,780	\$ 2,249	\$ 5,573	\$ 175	\$ 103,353	\$ 2,424

(In Thousands)	December 31, 2012					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Estimated	Gross	Estimated	Gross	Estimated	Gross
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	Losses
Obligations of U.S. Government Corporations and Agencies:						
Mortgage-backed	\$ 16,789	\$ 79	\$ 360	\$ 3	\$ 17,149	\$ 82
Other	5,975	25	-	-	5,975	25
Obligations of state and political subdivisions	2,062	12	-	-	2,062	12
Total debt securities	24,826	116	360	3	25,186	119
Equity securities	258	29	451	149	709	178
Total	\$ 25,084	\$ 145	\$ 811	\$ 152	\$ 25,895	\$ 297

At September 30, 2013, the Corporation had a total of 295 individual debt securities and 45 individual equity security positions. At September 30, 2013, there were a total of 86 individual debt securities and 4 individual equity securities that were in a continuous unrealized loss position for less than twelve months. At September 30, 2013, there were a total of 5 debt security and a total of 7 individual equity securities in a continuous loss position for greater than twelve months.

The Corporation invests in various forms of agency debt including mortgage-backed securities and callable agency debt. The fair market value of these securities is influenced by market interest rates, prepayment speeds on mortgage securities, bid to offer spreads in the market place and credit premiums for various types of agency debt. These factors change continuously and therefore the market value of these securities may be higher or lower than the Corporation's carrying value at any measurement date. The Corporation does not consider the debt securities contained in the previous table to be other-than-temporarily impaired since it has both the intent and ability to hold the securities until a recovery of fair value, which may be maturity.

The Corporation's marketable equity securities consist of common stock positions in various Commercial Banks, Savings and Loans/Thriffs, and Diversified Financial Service Corporations varying in asset size and geographic region. The following tables display the Corporation's holdings of these securities by asset size and geographic region as of September 30, 2013:

(In Thousands)	September 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Asset size(\$)				
Under \$1 Billion	\$ 390	\$ 201	\$ (18)	\$ 573
\$1 to \$5 Billion	538	134	(1)	671
\$6 to \$100 Billion	516	82	(40)	558
Over \$100 Billion	618	141	(17)	742
	\$ 2,062	\$ 558	\$ (76)	\$ 2,544

(In Thousands)	September 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Geographic Region				
Eastern U.S.	\$ 1,260	\$ 337	\$ (59)	\$ 1,538
Southeastern U.S.	110	20	-	130
Western U.S.	53	6	-	59
National	639	195	(17)	817
	\$ 2,062	\$ 558	\$ (76)	\$ 2,544

The fair market value of the equity securities tends to fluctuate with the overall equity markets as well as the trends specific to each institution. The equity securities portfolio is reviewed in a similar manner as that of the debt securities with greater emphasis placed on the length of time the market value has been less than the carrying value and the financial sector outlook. The Corporation also reviews dividend payment activities, levels of non performing assets and loan loss reserves. The starting point for the equity analysis is the length and severity of market value decline. The Corporation and an independent consultant monitor the entire portfolio quarterly with particular attention given to securities in a continuous loss position of at least ten percent for over twelve months. During 2012, a \$17 thousand impairment loss was recognized on a few securities which management believed that a sufficient amount of credit deterioration had occurred relative to the issuer's capital position to render the security unlikely to recover to our cost within the near term. For the nine months ended September 30, 2013 the Corporation did not record an other-than-temporary impairment related to the investment in these equity securities. The Corporation evaluated the near-term prospects of the issuer in relation the severity and duration of the market value decline as well as the other attributes listed above. Based on that evaluation and the Corporation's ability and intent to hold these equity securities for a reasonable period of time sufficient for a forecasted recovery of fair value, the Corporation does not consider these equity securities to be other-than-temporarily impaired at September 30, 2013.

**3. LOANS**

Major classifications of loans at September 30, 2013 and December 31, 2012 consisted of:

(In Thousands)

	2013	2012
Commercial, financial and agricultural	\$ 42,621	\$ 42,547
Tax-exempt	33,016	27,625
Commercial real estate:		
Commercial mortgages	94,328	93,392
Other construction and land development loans	13,555	10,144
Secured by farmland	6,544	6,510
Consumer real estate:		
Home equity loans	17,291	16,696
Home equity lines of credit	16,248	17,117
1-4 family residential mortgages	159,048	146,092
Construction	8,342	8,656
Installment loans to individuals	6,231	5,986
Unearned discount	-	-
Gross loans	\$ 397,224	\$ 374,765

### ***Loan Origination and Risk Management***

The Corporation has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and the Board of Directors approve these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Commercial, financial, and agricultural loans are underwritten after evaluating and understanding the borrower's ability to operate profitably. Underwriting standards are designed to promote relationship banking rather than transactional banking. Once it is determined that the borrower's management possesses sound ethics and solid business acumen, the Corporation's management examines current and projected cash flows to determine the ability of the borrower to repay their obligations as agreed. Commercial, financial, and agricultural loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial, financial, and agricultural loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial, financial, and agricultural loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Corporation's commercial real estate portfolio are diverse in terms of type and geographic locations served by the Corporation. This diversity helps reduce the Corporation's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral. As a general rule the Corporation avoids financing single-purpose projects unless other underwriting factors are present to help mitigate risk.

The Corporation originates consumer loans using a credit scoring system to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are reviewed and modified on a regular basis. In addition, risk is reduced by keeping the loan amounts relatively small and spread across many individual borrowers. Additionally, trend reports are reviewed regularly by management. Underwriting standards for home equity loans are influenced by statutory requirements, which include such controls as maximum loan-to-value percentages, collection remedies, documentation requirements, and limits on the number of loans an individual can have at one time.

The Corporation contracts an independent third party consultant that reviews and validates the credit risk program on an annual basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Corporation's loan policies and procedures.

Real estate loans held-for-sale in the amount of \$12,106,000 at September 30, 2013 and \$10,824,000 at December 31, 2012 are included in consumer real estate loans above and are carried at the lower of cost or market. The aggregate amount of demand deposits that have been reclassified as consumer loan balances at September 30, 2013 and December 31, 2012 amounted to \$98,000 and \$120,000, respectively.

The Corporation uses the following definitions for risk ratings, which are consistent with the definitions used in supervisory guidance:

**Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the

loan or of the institution's credit position at some future date.

**Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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

Loans not meeting the criteria above are analyzed individually as part of the above described process and are considered to be passing rated loans.

As of September 30, 2013, based on the most recent credit analysis performed, the risk category of loans by class of loans (including loans held for sale) is as follows:

(In Thousands)	September 30, 2013				
	Commercial, Financial & Agricultural, Exempt	Commercial Real Estate	Consumer Real Estate	Installment Loans to Individuals	Total
Pass	\$ 70,886	\$ 103,466	\$ 195,944	\$ 6,225	\$ 376,521
Special Mention	2,169	3,797	759	-	6,725
Substandard	2,582	7,164	4,226	6	13,978
Doubtful	-	-	-	-	-
Total	\$ 75,637	\$ 114,427	\$ 200,929	\$ 6,231	\$ 397,224

As of December 31, 2012, based on the most recent analysis performed, the risk category of loans by class of loans (including loans held for sale) is as follows:

(In Thousands)	December 31, 2012				
	Commercial, Financial & Agricultural, Exempt	Commercial Real Estate	Consumer Real Estate	Installment Loans to Individuals	Total
Pass	\$ 67,772	\$ 97,156	\$ 186,404	\$ 5,965	\$ 357,297
Special Mention	509	2,214	-	-	2,723
Substandard	1,891	10,676	2,157	21	14,745
Doubtful	-	-	-	-	-
Total	\$ 70,172	\$ 110,046	\$ 188,561	\$ 5,986	\$ 374,765

### ***Concentrations of Credit Risk***

Most of the Corporation's lending activity occurs within the Bank's primary market area which encompasses Columbia County, a 484 square mile area located in North Central Pennsylvania. The majority of the Corporation's loan portfolio consists of commercial real estate and consumer real estate loans. As of September 30, 2013 and December 31, 2012, there were no concentrations of loans related to any single industry in excess of 10% of total loans.

### ***Non-Accrual and Past Due Loans***

Generally, a loan is classified as non-accrual; with the accrual of interest on such a loan discontinued when the contractual payment of principal or interest has become 90-days past due or management has serious doubts about further collectability of principal or interest, even though the loan may be currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well-secured. When a loan is placed on non-accrual status, unpaid interest credited to income in the current year is reversed, and unpaid interest accrued in prior years is charged against the allowance for loan losses. Certain non-accrual loans may continue to perform wherein payments are still being received with those payments generally applied to principal. Non-accrual loans remain under constant scrutiny and if performance continues, interest income may be recorded on a cash basis based on management's judgment as to collectability of principal.

Non-accrual loans, segregated by class of loans, were as follows as of September 30, 2013 and December 31, 2012:

(In Thousands)	September 30, 2013	December 31, 2012
Commercial, financial and agricultural	\$ 411	\$ 586
Tax-exempt	-	-
Commercial real estate:		
Commercial mortgages	1,085	1,192
Other construction and land development loans	-	-
Secured by farmland	-	-
Consumer real estate:		
Home equity loans	232	279
Home equity lines of credit	-	-
1-4 family residential mortgages	1,512	1,123
Construction	-	-
Installment loans to individuals	10	36
Total	\$ 3,250	\$ 3,216

At September 30, 2013 and December 31, 2012, there were no significant commitments to lend additional funds with respect to non-accrual and restructured loans.

Generally, a loan is considered past due when a payment is in arrears for a period of 10 or 15 days, depending on the type of loan. Delinquent notices are issued at this point and collection efforts will continue on loans past due beyond

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60 days which have not been satisfied. Past due loans are continually evaluated with determination for charge-off being made when no reasonable chance remains that the status of the loan can be improved.

An aging analysis of past due loans, segregated by class of loans, as of September 30, 2013 and December 31, 2012 were as follows:

(In Thousands)	September 30, 2013		Total Past Due Loans	Current Loans	Total Loans	Accruing Loans 90 or more Days Past Due
	Loans 30-89 Days Past Due	Non-accrual				
Commercial, financial and agricultural	\$ 19	\$ 411	\$ 430	\$ 42,191	\$ 42,621	\$ -
Tax-exempt	-	-	-	33,016	33,016	-
Commercial real estate:						
Commercial mortgages	652	1,085	1,737	92,591	94,328	-
Other construction and land development loans	468	-	468	13,087	13,555	-
Secured by farmland	310	-	310	6,234	6,544	-
Consumer real estate:						
Home equity loans	227	232	459	16,832	17,291	-
Home equity lines of credit	50	-	50	16,198	16,248	-
1-4 family residential mortgages	817	1,512	2,329	156,719	159,048	-
Construction	-	-	-	8,342	8,342	-
Installment loans to individuals	35	10	45	6,186	6,231	-
Unearned discount	-	-	-	-	-	-
Gross loans	\$ 2,578	\$ 3,250	\$ 5,828	\$ 391,396	\$ 397,224	\$ -

(In Thousands)	December 31, 2012					Accruing Loans 90 or more Days Past Due
	Loans 30-89 Days Past Due	Non-accrual	Total Past Due Loans	Current Loans	Total Loans	
Commercial, financial and agricultural	\$ 69	\$ 586	\$ 655	\$ 41,892	\$ 42,547	\$ -
Tax-exempt	-	-	-	27,625	27,625	-
Commercial real estate:						
Commercial mortgages	379	1,192	1,571	91,821	93,392	-
Other construction and land development loans	-	-	-	10,144	10,144	-
Secured by farmland	-	-	-	6,510	6,510	-
Consumer real estate:						
Home equity loans	194	279	473	16,223	16,696	-
Home equity lines of credit	-	-	-	17,117	17,117	-
1-4 family residential mortgages	1,557	1,123	2,680	143,412	146,092	-
Construction	-	-	-	8,656	8,656	-
Installment loans to individuals	17	36	53	5,933	5,986	-
Unearned discount	-	-	-	-	0	-
Gross loans	\$ 2,216	\$ 3,216	\$ 5,432	\$ 369,333	\$ 374,765	\$ -

There were no loans past due 90 days and still accruing interest at September 30, 2013 and December 31, 2012.

### **Impaired Loans**

A loan is considered impaired when, based on current information and events, it is probable the Corporation will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments. Impairment is evaluated in smaller-balance loans of a similar nature and on an individual basis for other loans. If a loan is impaired, a specific allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above.

No additional charge to operations was required to provide for these impaired loans as the specifically allocated allowance of \$600,000 at September 30, 2013, is estimated by management to be adequate to provide for the loan loss allowance associated with these impaired loans.

Impaired loans are set forth in the following table as of September 30, 2013 and December 31, 2012:

(In Thousands)	September 30, 2013				
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Commercial, financial and agricultural	\$ 780	\$ 269	\$ 511	\$ 780	\$ 272
Tax-exempt	-	-	-	-	-
Commercial real estate:					
Commercial mortgages	1,230	276	954	1,230	166
	-	-	-	-	-



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Other construction and land development loans					
Secured by farmland	442	442	-	442	-
Consumer real estate:					
Home equity loans	152	80	72	152	37
Home equity lines of credit	21	21	-	21	-
1-4 family residential mortgages	2,077	1,422	655	2,077	119
Construction	-	-	-	-	-
Installment loans to individuals	6	-	6	6	6
Gross loans	\$ 4,708	\$ 2,510	\$ 2,198	\$ 4,708	\$ 600

(In Thousands)	December 31, 2012				
	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
Commercial, financial and agricultural	\$ 863	\$ 423	\$ 440	\$ 863	\$ 105
Tax-exempt	-	-	-	-	-
Commercial real estate:					
Commercial mortgages	1,357	200	1,157	1,357	369
Other construction and land development loans	-	-	-	-	-
Secured by farmland	448	448	-	448	-
Consumer real estate:					
Home equity loans	325	122	203	325	140
Home equity lines of credit	-	-	-	-	-
1-4 family residential mortgages	1,145	768	377	1,145	64
Construction	-	-	-	-	-
Installment loans to individuals	21	-	21	21	15
Gross loans	\$ 4,159	\$ 1,961	\$ 2,198	\$ 4,159	\$ 693

**Allowance for Possible Loan Losses**

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is maintained at a level established by management to be adequate to absorb estimated potential loan losses. Management's periodic evaluation of the adequacy of the allowance for loan losses is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change.

The following table details activity in the allowance for possible loan losses by portfolio segment for the nine months ended September 30, 2013 and 2012. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

(In Thousands)	September 30, 2013					
	Commercial Financial & Agricultural, Ex	Commercial Real Estate	Consumer Real Estate	Installment Loans Individuals	Unallocated	Total
Balance, beginning of year	\$ 870	\$ 2,220	\$ 1,741	\$ 98	\$ 1,257	\$ 6,186
Provision charged to operations	263	(636)	793	53	(383)	90
Loans charged off	(24)	-	(90)	(56)	-	(170)
Recoveries	2	-	6	14	-	22
Ending balance	\$ 1,111	\$ 1,584	\$ 2,450	\$ 109	\$ 874	6,128
Ending balance individually evaluated for impairment	\$ 272	\$ 166	\$ 156	\$ 6	\$ -	\$ 600
Ending balance collectively evaluated for impairment	\$ 839	\$ 1,418	\$ 2,294	\$ 103	\$ 874	\$ 5,528
(In Thousands)	September 30, 2012					
	Commercial Financial & Agricultural, Ex	Commercial Real Estate	Consumer Real Estate	Installment Loans Individuals	Unallocated	Total
Balance, beginning of year	\$ 959	\$ 1,701	\$ 1,635	\$ 131	\$ 957	\$ 5,383
Provision charged to operations	(123)	203	75	20	190	365
Loans charged off	-	-	(42)	(38)	-	(80)
Recoveries	-	-	12	14	-	26
Ending balance	\$ 836	\$ 1,904	\$ 1,680	\$ 127	\$ 1,147	5,694
Ending balance individually evaluated for impairment	\$ 54	\$ 532	\$ 110	\$ 27	\$ -	\$ 723

Ending balance collectively evaluated for impairment	\$ 782	\$ 1,372	\$ 1,570	\$ 100	\$ 1,147	\$ 4,971
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The Corporation's recorded investment in loans as of September 30, 2013 and December 31, 2012 related to each balance in the allowance for possible loan losses by portfolio segment and disaggregated on the basis of the Corporation's impairment methodology was as follows:

(In Thousands)	September 30, 2013				Total
	Commercial Financial & Agricultural, Executive	Commercial Real Estate	Consumer Real Estate	Installment Loans Individuals	
Ending balance individually evaluated for impairment	\$ 780	\$ 1,672	\$ 2,250	\$ 6	\$ 4,708
Ending balance collectively evaluated for impairment	74,857	112,755	198,679	6,225	392,516
Ending balance	\$ 75,637	\$ 114,427	\$ 200,929	\$ 6,231	\$ 397,224

(In Thousands)	December 31, 2012				
	Commercial Financial & Agricultural, Exempt	Commercial Real Estate	Consumer Real Estate	Installment Loans Individuals	Total
Ending balance individually evaluated for impairment	\$ 863	\$ 1,805	\$ 1,470	\$ 21	\$ 4,159
Ending balance collectively evaluated for impairment	69,309	108,241	187,091	5,965	370,606
Ending balance	\$ 70,172	\$ 110,046	\$ 188,561	\$ 5,986	\$ 374,765

**Loan Modifications**

From time to time, the Bank may agree to modify the contractual terms of a borrower's loan. In cases where such modifications represent a concession to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring. Loans modified in a troubled debt restructuring are placed on nonaccrual status until the Bank determines the future collection of principal and interest is reasonably assured, which generally requires that the borrower demonstrate a period of performance according to the restructured terms of six months. Loan modifications considered troubled debt restructurings completed during the nine months ended September 30, 2013 and 2012 were as follows:

(In Thousands)	2013				
	Commercial Financial & Agricultural, Exempt	Commercial Real Estate	Consumer Real Estate	Installment Loans Individuals	Total
Number of contracts	-	-	-	-	-
Pre-modification outstanding recorded investment	\$ -	\$ -	\$ -	\$ -	\$ -
Post-modification outstanding recorded investment	\$ -	\$ -	\$ -	\$ -	\$ -

(In Thousands)	2012				
	Commercial Financial & Agricultural, Exempt	Commercial Real Estate	Consumer Real Estate	Installment Loans Individuals	Total
Number of contracts	4	1	2	-	7
Pre-modification outstanding recorded investment	\$ 589	\$ 37	\$ 108	\$ -	\$ 734
Post-modification outstanding recorded investment	\$ 589	\$ 37	\$ 108	\$ -	\$ 734

#### **4. SHORT-TERM BORROWINGS**

Securities sold under agreements to repurchase and Federal Home Loan Bank advances generally represented overnight or less than 30-day borrowings. U.S. Treasury tax and loan notes for collections made by the Bank were payable on demand.

#### **5. LONG-TERM BORROWINGS**

Long-term borrowings consist of advances due to the FHLB - Pittsburgh.

#### **6. DEFERRED COMPENSATION PLANS**

The Bank has entered into certain non-qualified deferred compensation agreements with certain present and retired executive officers and directors. Expenses related to these non-qualified deferred compensation plans amounted to \$125,000 and \$133,000 for the nine month period ended September 30, 2013 and 2012, respectively.

#### **7. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK AND CONCENTRATIONS OF CREDIT RISK**

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments. The Corporation does not engage in trading activities with respect to any of its financial instruments with off-balance sheet risk.

The Corporation may require collateral or other security to support financial instruments with off-balance sheet credit risk. The contract or notional amounts at September 30, 2013 and December 31, 2012 were as follows:

(In Thousands)	2013	2012
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 68,726	\$ 69,897
Standby letters of credit	3,077	3,313
Dealer floor plans	1,576	1,586
Loans held for sale	12,106	10,824

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

Standby letters of credit and commercial letters of credit are conditional commitments issued by the Corporation to guarantee payment to a third party when a customer either fails to repay an obligation or fails to perform some non-financial obligation. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation holds collateral supporting those commitments for which collateral is deemed necessary.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations, as it does for on-balance sheet instruments.

The Corporation granted commercial, consumer and residential loans to customers primarily within Pennsylvania. Of the total loan portfolio, 79.4% was for real estate loans, with the highest percentage being residential. It is the opinion of management that this high concentration did not pose an adverse credit risk. Further, it is management's opinion that the remainder of the loan portfolio is balanced and diversified to the extent necessary to avoid any significant concentration of credit.

## 8. FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the Corporation adopted FASB ASC 820-10 (SFAS No. 157), which, among other things, requires enhanced disclosures about assets and liabilities carried at fair value. FASB ASC 820-10 establishes a hierarchal disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The standard describes three levels of inputs that may be used to measure fair values:

- 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 of which can be directly observed.
- Level III: Assets and liabilities that have little or 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

determination of fair value require significant management judgment or estimation.

The following table presents the assets reported on the consolidated statements of financial condition at their fair value as of September 30, 2013 and December 31, 2012 by level within the fair value hierarchy. As required by FASB ASC 820-10, 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, 2013			Total
	Level I	Level II	Level III	
Assets Measured on a Recurring Basis:				
Investment Securities, available-for-sale	\$ 2,544	\$ 179,120	\$ -	\$ 181,664

(In Thousands)	December 31, 2012			Total
	Level I	Level II	Level III	
Assets Measured on a Recurring Basis:				
Investment Securities, available-for-sale	\$ 2,104	\$ 168,340	\$ -	\$ 170,444

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At September 30, 2013 and December 31, 2012, investments measured at fair value on a recurring basis and the valuation methods used are as follows:

(In Thousands)	September 30, 2013			Total
	Level I	Level II	Level III	
Available for sale securities				
Obligation of US Government Agencies				
Mortgage-backed	\$ -	\$ 97,317	\$ -	\$ 97,317
Other	-	47,008	-	47,008
Obligations of state and political subdivisions	-	34,795	-	34,795
Equity securities	2,544	-	-	2,544
	\$ 2,544	\$ 179,120	\$ -	\$ 181,664

  

(In Thousands)	December 31, 2012			Total
	Level I	Level II	Level III	
Available for sale securities				
Obligation of US Government Agencies				
Mortgage-backed	\$ -	\$ 100,977	\$ -	\$ 100,977
Other	-	40,168	-	40,168
Obligations of state and political subdivisions	-	27,195	-	27,195
Equity securities	2,104	-	-	2,104
	\$ 2,104	\$ 168,340	\$ -	\$ 170,444

The estimated fair values of equity securities classified as Level I are derived from quoted market prices in active markets; these assets consists mainly of stocks held in other banks. The estimated fair values of all debt securities classified as Level II are obtained from nationally-recognized third-party pricing agencies. The estimated fair values are derived primarily from cash flow models, which include assumptions for interest rates, credit losses, and prepayment speeds. The significant inputs utilized in the cash flow models are based on market data obtained from sources independent of the Corporation (observable inputs), and are therefore classified as Level II within the fair value hierarchy.

The following table presents certain assets reported on the consolidated statements of financial condition at their fair value on a non-recurring basis as of September 30, 2013 and December 31, 2012 by level within the fair value hierarchy. As required by FASB ASC 820-10, 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, 2013			Total
	Level I	Level II	Level III	
Assets Measured on a Non-recurring Basis:				
Impaired Loans	\$ -	\$ 4,714	\$ -	\$ 4,714
Loans Held for Sale	-	12,106	-	12,106
Mortgage Servicing Rights	-	916	-	916
Other Real Estate Owned	-	12	-	12
	\$ -	\$ 17,748	\$ -	\$ 17,748

  

(In Thousands)	December 31, 2012			Total
	Level I	Level II	Level III	
Assets Measured on a Non-recurring Basis:				
Impaired Loans	\$ -	\$ 4,159	\$ -	\$ 4,159
Loans Held for Sale	-	10,824	-	10,824
Mortgage Servicing Rights	-	820	-	820



Other Real Estate Owned	-	-	-	-
	\$ -	\$ 15,803	\$ -	\$ 15,803

**9. ESTIMATED FAIR VALUES OF FINANCIAL INSTRUMENTS**

The Corporation is required to disclose estimated fair values for its financial instruments. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. These techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Fair value estimates derived through these techniques cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. FASB ASC 825-10 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Corporation.

At September 30, 2013 and December 31, 2012, the carrying values and estimated fair values of financial instruments are presented in the table below:

(In Thousands)	September 30, 2013		December 31, 2012	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial Assets:</b>				
Cash and short-term instruments	\$ 13,483	\$ 13,483	\$ 22,591	\$ 22,591
Investment securities	181,664	181,664	170,444	170,444
Restricted securities	4,056	4,056	3,355	3,355
Loans held for sale	12,106	12,106	10,824	10,824
Loans, net	378,990	377,744	357,755	360,457
Cash surrender value of bank owned life insurance	15,392	15,392	14,975	14,975
Accrued interest receivable	1,606	1,606	1,592	1,592
<b>Financial Liabilities:</b>				
Interest-bearing deposits	381,798	383,406	382,133	384,345
Noninterest-bearing deposits	77,461	77,461	80,895	80,895
Short-term borrowings	93,159	93,159	64,026	64,026
Long-term borrowings	2,108	2,168	4,112	4,242
Accrued interest payable	275	275	333	333
<b>Off-Balance Sheet Assets (Liabilities):</b>				
Commitments to extend credit		\$ 68,726		\$ 69,897
Standby letters of credit		3,077		3,313
Dealer floor plans		1,576		1,586

The following methods and assumptions were used by the Corporation in estimating its fair value disclosures for financial instruments:

#### CASH AND OTHER SHORT-TERM INSTRUMENTS

Cash and due from banks, interest bearing deposits with other banks, and Federal Funds sold had carrying values which were a reasonable estimate of fair value. Accordingly, fair values regarding these instruments were provided by reference to carrying values reflected on the consolidated balance sheets.

#### INVESTMENT SECURITIES

The fair value of investment securities which included mortgage backed securities were estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers.

#### RESTRICTED SECURITIES

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

#### LOANS

Fair values were estimated for categories of loans with similar financial characteristics. Loans were segregated by type such as commercial, tax-exempt, real estate mortgages and consumer. For estimation purposes, each loan category was further segmented into fixed and adjustable rate interest terms and also into performing and non-performing classifications.

The fair value of each category of performing loans was calculated by discounting future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Fair value for non-performing loans was based on management's estimate of future cash flows discounted using a rate commensurate with the risk associated with the estimated future cash flows. The assumptions used by management

were judgmentally determined using specific borrower information.

**CASH SURRENDER VALUE OF BANK OWNED LIFE INSURANCE**

The fair values are equal to the current carrying value.

**ACCRUED INTEREST RECEIVABLE AND PAYABLE**

The fair values are equal to the current carrying value.

**DEPOSITS**

The fair value of deposits with no stated maturity, such as Demand Deposits, Savings Accounts, and Money Market Accounts, was equal to the amount payable on demand at September 30, 2013 and December 31, 2012.

Fair values for fixed rate Certificates of Deposit were estimated using a discounted cash flow calculation that applied interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

#### SHORT-TERM BORROWINGS

The carrying amounts of federal funds purchased and securities sold under agreements to repurchase and other short-term borrowings approximated their fair values.

#### LONG-TERM BORROWINGS

The fair values of long-term borrowings, other than capitalized leases, are estimated using discounted cash flow analyses based on the Corporation's incremental borrowing rate for similar instruments. The carrying amounts of capitalized leases approximated their fair values, because the incremental borrowing rate used in the carrying amount calculation was at the market rate.

#### COMMITMENTS TO EXTEND CREDIT AND STANDBY LETTERS OF CREDIT

Management estimated that there were no material differences between the notional amount and the estimated fair value of those off-balance sheet items, because they were primarily composed of unfunded loan commitments which were generally priced at market value at the time of funding.

### **10. MANAGEMENT'S ASSERTIONS AND COMMENTS REQUIRED TO BE PROVIDED WITH FORM 10-Q FILING**

In management's opinion, the consolidated interim financial statements reflect fair presentation of the consolidated financial position of the Corporation, and the results of its operations and its cash flows for the interim periods presented. Further, the consolidated interim financial statements are unaudited, however they reflect all adjustments, which are in the opinion of management, necessary to present fairly the consolidated financial condition and consolidated results of operations and cash flows for the interim periods presented and that all such adjustments to the consolidated financial statements are of a normal recurring nature.

These consolidated interim financial statements have been prepared in accordance with requirements of Form 10-Q and therefore do not include all disclosures normally required by accounting principles generally accepted in the United States of America applicable to financial institutions as included with consolidated financial statements included in the Corporation's annual Form 10-K filing. The reader of these consolidated interim financial statements may wish to refer to the Corporation's annual report or Form 10-K for the period ended December 31, 2012 filed with the Securities and Exchange Commission.

#### **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders of CCFNB Bancorp, Inc.:

We have reviewed the consolidated balance sheet of CCFNB Bancorp, Inc. and Subsidiary as of September 30, 2013 and the related consolidated statements of income, comprehensive statements of income, changes in stockholders' equity and comprehensive income for the three month and nine month periods ended September 30, 2013 and 2012 and the consolidated statement of cash flows for the nine month periods ended September 30, 2013 and 2012. These consolidated interim financial statements are the responsibility of the management of CCFNB Bancorp, Inc. and Subsidiary.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of CCFNB Bancorp, Inc. and Subsidiary as of December 31, 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 5, 2013, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2012, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ J. H. Williams & Co., LLP

J.H. Williams & Co., LLP  
Kingston, Pennsylvania  
November 13, 2013

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

**CAUTIONARY STATEMENT**

Certain statements in this section and elsewhere in this Quarterly Report on Form 10-Q, other periodic reports filed by us under the Securities Exchange Act of 1934, as amended, and any other written or oral statements made by or on behalf of us may include "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 which reflect our current views with respect to future events and financial performance. Such forward looking statements are based on general assumptions and are subject to various risks, uncertainties, and other factors that may cause actual results to differ materially from the views, beliefs and projections expressed in such statements. These risks, uncertainties and other factors include, but are not limited to:

- Our business and financial results are affected by business and economic conditions, both generally and specifically in the mostly North Central Pennsylvania market in which we operate.
- Changes in interest rates and valuations in the debt, equity and other financial markets.
- Disruptions in the liquidity and other functioning of financial markets, including such disruptions in the market for real estate and other assets commonly securing financial products.
- Actions by the Federal Reserve Board and other government agencies, including those that impact money supply and market interest rates.
- Changes in our customers' and suppliers' performance in general and their creditworthiness in particular.
- Changes in customer preferences and behavior, whether as a result of changing business and economic conditions or other factors.
- Changes resulting from the enacted Dodd-Frank Wall Street Reform and Consumer Protection Act.
- A continuation of recent turbulence in significant segments of the United States and global financial markets, particularly if it worsens, could impact our performance, both directly by affecting our revenues and the value of our assets and liabilities and indirectly by affecting our customers and suppliers and the economy generally.
- Our business and financial performance could be impacted as the financial industry restructures in the current environment by changes in the competitive landscape.
- Given current economic and financial market conditions, our forward-looking statements are subject to the risk that these conditions will be substantially different than we are currently expecting. These statements are based on our current expectations that interest rates will remain low throughout the remainder of 2013 and into 2014.
- Legal and regulatory developments could have an impact on our ability to operate our businesses or our financial condition or results of operations or our competitive position or reputation. Reputational impacts, in turn, could affect matters such as business generation and retention, our ability to attract and retain management, liquidity and funding. These legal and regulatory developments could include: (a) the unfavorable resolution of legal proceedings or regulatory and other governmental inquiries; (b) increased litigation risk from recent regulatory and other governmental developments; (c) the results of the regulatory examination process, and regulators' future use of supervisory and enforcement tools; (d) legislative and regulatory reforms, including changes to laws and regulations involving tax, pension, education and mortgage lending, the protection of confidential customer information, and other aspects of the financial institution industry; and (e) changes in accounting policies and principles.

- Our business and operating results are affected by our ability to identify and effectively manage risks inherent in our businesses, including, where appropriate, through the effective use of third-party insurance and capital management techniques.
- Our ability to anticipate and respond to technological changes can have an impact on our ability to respond to customer needs and to meet competitive demands.
- Our ability to implement our business initiatives and strategies could affect our financial performance over the next several years.
- Competition can have an impact on customer acquisition, growth and retention, as well as on our credit spreads and product pricing, which can affect market share, deposits and revenues.

- Our business and operating results can also be affected by widespread natural disasters, terrorist activities or international hostilities, either as a result of the impact on the economy and capital and other financial markets generally or on us or on our customers and suppliers. During September 2011 Tropical Storm Lee caused flooding to portions of our operating area. Specifically two of our branch offices were impacted sustaining light to moderate damage. The Corporation's insurance claim covered a significant portion of the damage. Our Benton office sustained light damage and was operational within a few days of the incident. Our Bloomsburg Market Street office, which is a leased facility, was reopened during the second quarter of 2012.
- Exploration and drilling of the Marcellus Shale natural gas reserves 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 deposit volume and loan quality.

The words "believe," "expect," "anticipate," "project" and similar expressions signify forward looking statements. Readers are cautioned not to place undue reliance on any forward looking statements made by or on behalf of us. Any such statement speaks only as of the date the statement was made. We undertake no obligation to update or revise any forward looking statements.

The following discussion and analysis should be read in conjunction with the detailed information and consolidated financial statements, including notes thereto, included elsewhere in this report. Our consolidated financial condition and results of operations are essentially those of our subsidiary, the Bank. Therefore, the analysis that follows is directed to the performance of the Bank.

## **RESULTS OF OPERATIONS**

### **NET INTEREST INCOME**

#### **2013 vs. 2012**

Tax-equivalent net interest income, as reflected in the following tables, decreased \$939 thousand to \$14.3 million at September 30, 2013 when compared to the same 2012 time period. Reported tax-equivalent interest income decreased \$1.7 million to \$16.2 million for the nine months ended September 30, 2013 when compared to the same 2012 time period. The decrease to interest income was primarily rate driven as maturing and called investment securities as well as loans repriced throughout the past year. Investment security tax-equivalent interest income for the nine months ended September 30, 2013 decreased \$1.0 million when compared to 2012 results. Loan interest income for the nine months ended September 30, 2013 decreased \$679 thousand when compared to 2012 results. Reported interest expense decreased \$807 thousand to \$1.9 million for the nine months ended September 30, 2013 when compared to the same 2012 time period. The decrease was primarily rate driven as maturing time deposits re-priced during the year lowering the average rate paid on interest-bearing deposits to 0.58 percent for the nine months ended September 30, 2013 from 0.82 percent at September 30, 2012. Net interest margin decreased to 3.31 percent at September 30, 2013 from 3.52 percent at September 30, 2012.

The following Average Balance Sheet and Rate Analysis table presents the average assets, actual income or expense and the average yield on assets, liabilities and stockholders' equity for the nine months ended September 30, 2013 and 2012.



## AVERAGE BALANCE SHEET AND RATE ANALYSIS

NINE MONTHS ENDED SEPTEMBER 30,

(In Thousands)

	2013			2012			Average Rate	
	Average Balance (1)	Interest	Average Rate	Average Balance (1)	Interest	Average Rate		
<b>ASSETS:</b>								
Tax-exempt loans	\$ 31,188	\$ 1,216	5.21	%	\$ 26,776	\$ 1,264	6.31	%
All other loans	347,016	12,294	4.74	%	324,978	12,925	5.32	%
Total loans (2)(3)(4)	378,204	13,510	4.78	%	351,754	14,189	5.39	%
Taxable securities	152,760	1,739	1.52	%	176,491	2,897	2.19	%
Tax-exempt securities (3)	30,177	893	3.95	%	22,918	783	4.56	%
Total securities	182,937	2,632	1.92	%	199,409	3,680	2.46	%
Federal funds sold	1,867	1	0.07	%	1,932	1	0.07	%
Interest-bearing deposits	13,199	25	0.25	%	23,862	44	0.25	%
Total interest-earning assets	576,207	16,168	3.75	%	576,957	17,914	4.15	%
Other assets	44,723				44,319			
<b>TOTAL ASSETS</b>	<b>\$ 620,930</b>				<b>\$ 621,276</b>			
<b>LIABILITIES:</b>								
Savings	\$ 82,682	40	0.06	%	\$ 74,791	84	0.15	%
Now deposits	78,521	44	0.07	%	77,881	42	0.07	%
Money market deposits	49,031	59	0.16	%	46,260	71	0.21	%
Time deposits	180,658	1,549	1.15	%	200,731	2,250	1.50	%
Total deposits	390,892	1,692	0.58	%	399,663	2,447	0.82	%
Short-term borrowings	70,402	146	0.28	%	58,663	164	0.37	%
Long-term borrowings	3,286	72	2.93	%	5,298	106	2.68	%
Junior subordinate debentures	-	-	0.00	%	-	-	0.00	%
Total borrowings	73,688	218	0.40	%	63,961	270	0.56	%
Total interest-bearing liabilities	464,580	1,910	0.55	%	463,624	2,717	0.78	%
Demand deposits	77,680				80,903			
Other liabilities	3,537				3,663			
Stockholders' equity	75,133				73,086			
<b>TOTAL LIABILITIES</b>								
<b>AND</b>								
<b>STOCKHOLDERS'</b>	<b>\$ 620,930</b>				<b>\$ 621,276</b>			
<b>EQUITY</b>								
Interest rate spread (6)			3.20	%			3.37	%
Net interest income/margin (5)		\$ 14,258	3.31	%		\$ 15,197	3.52	%

- (1) Average volume information was compared using daily (or monthly) averages for interest-earning and bearing accounts. Certain balance sheet items utilized quarter-end balances for averages.
- (2) Interest on loans includes fee income.
- (3) Tax exempt interest revenue is shown on a tax-equivalent basis using a statutory federal income tax rate of 34 percent for 2013 and 2012.
- (4) Nonaccrual loans have been included with loans for the purpose of analyzing net interest earnings.
- (5) Net interest margin is computed by dividing annualized net interest income by total interest earning assets.
- (6) Interest rate spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities.

Reconciliation of Taxable Equivalent Net Interest Income  
For the Nine Months Ended September 30,

(In Thousands)	2013	2012
Total interest income	\$ 15,450	\$ 17,219
Total interest expense	1,910	2,718
Net interest income	13,540	14,501
Tax equivalent adjustment	718	696
Net interest income (fully taxable equivalent)	\$ 14,258	\$ 15,197

**Rate/Volume Analysis**

To enhance the understanding of the effects of volumes (the average balance of earning assets and costing liabilities) and average interest rate fluctuations on the consolidated balance sheet as it pertains to net interest income, the table below reflects these changes for 2013 versus 2012:

(In Thousands)	Nine Months Ended September 30, 2013 vs 2012 Increase (Decrease) Due to		
	Volume	Rate	Net
<b>Interest income:</b>			
Loans, tax-exempt	\$ 172	\$ (220)	\$ (48)
Loans	781	(1,412)	(631)
Taxable investment securities	(270)	(888)	(1,158)
Tax-exempt investment securities	215	(105)	110
Federal funds sold	-	-	-
Interest bearing deposits	(20)	-	(20)
Total interest-earning assets	878	(2,625)	(1,747)
<b>Interest expense:</b>			
Savings	4	(48)	(44)
NOW deposits	-	1	1
Money market deposits	3	(15)	(12)
Time deposits	(172)	(529)	(701)
Short-term borrowings	24	(42)	(18)
Long-term borrowings, FHLB	(44)	10	(34)
Total interest-bearing liabilities	(185)	(623)	(808)
Change in net interest income	\$ 1,063	\$ (2,002)	\$ (939)

**PROVISION FOR LOAN LOSSES**

**2013 vs. 2012**

The provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, evaluate potential charge-offs and recoveries, and assess the general conditions in the markets served. Management remains committed to an aggressive and thorough program of problem loan identification and resolution. Annually, an independent loan review is performed for the Bank. The allowance for loan losses is evaluated quarterly and is calculated by applying historic loss factors to the various outstanding loans types while excluding loans for which a specific allowance has

already been determined. Loss factors are based on management's consideration of the nature of the portfolio segments, historical loan loss experience, industry standards and trends with respect to nonperforming loans, and its core knowledge and experience with specific loan segments.

Although management believes that it uses the best information available to make such determinations and that the allowance for loan losses is adequate at September 30, 2013, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy or employment and delays in receiving financial information from borrowers could result in increased levels of nonperforming assets and charge-offs, increased loan loss provisions and reductions in interest income. Also, as part of the examination process, bank regulatory agencies periodically review the Bank's loan loss allowance. The bank regulators could require the recognition of additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

The provision for loan losses amounted to \$90,000 and \$365,000 for the nine months ended September 30, 2013 and 2012, respectively. Management concluded the 2013 and 2012 increases of the provision were appropriate considering the gross loan growth experience, the level of nonperforming assets and the general condition of the national economy. Utilizing the resources noted above, management concluded that the allowance for loan losses remains at a level adequate to provide for probable losses inherent in the loan portfolio.

## NON-INTEREST INCOME

### 2013 vs. 2012

Total non-interest income decreased \$507 thousand or 6.5 percent to \$4.6 million for the nine months ended September 30, 2013. The service charges and fees decreased \$102 thousand or 9.2 percent to \$1.0 million for the nine months ended September 30, 2013. Gain on sale of loans decreased \$337 thousand or 27.9 percent from \$1.2 million in 2012 to \$871 thousand in 2013. Brokerage income increased \$18 thousand or 5.4 percent from \$331 thousand in 2012 to \$349 thousand in 2013.

(In Thousands)	For The Nine Months Ended								
	September 30, 2013			September 30, 2012			Change		
	Amount	% Total	%	Amount	% Total	%	Amount	%	
Service charges and fees	\$ 1,008	22.0	%	\$ 1,110	21.9	%	\$ (102)	(9.2)	%
Gain on sale of loans	871	19.1		1,208	23.8		(337)	(27.9)	
Earnings on bank-owned life insurance	359	7.9		381	7.5		(22)	(5.8)	
Brokerage	349	7.6		331	6.5		18	5.4	
Trust	433	9.5		467	9.2		(34)	(7.3)	
Investment security (losses) gains	65	1.4		(17)	(0.3)		82	-	
Interchange fees	829	18.2		783	15.4		46	5.9	
Other	653	14.3		811	16.0		(158)	(19.5)	
Total non-interest income	\$ 4,567	100.0	%	\$ 5,074	100.0	%	\$ (507)	(10.0)	%

## NON-INTEREST EXPENSE

### 2013 vs. 2012

Total non-interest expense decreased \$283 thousand or 2.4 percent from \$11.9 million in 2012. Salaries decreased \$9 thousand, employee benefits increased \$128 thousand, occupancy increased \$55 thousand, furniture and fixtures decreased \$13 thousand, and automated teller machine and interchange decreased \$142 thousand.

One standard to measure non-interest expense is to express annualized non-interest expense as a percentage of average total assets. As of September 30, 2013 this percentage was 2.50 percent compared to 2.56 percent in 2012.

(In Thousands)	For The Nine Months Ended								
	September 30, 2013			September 30, 2012			Change		
	Amount	% Total	%	Amount	% Total	%	Amount	%	
Salaries	\$ 4,873	41.8	%	\$ 4,882	40.8	%	\$ (9)	(0.2)	%
Employee benefits	1,607	13.8		1,479	12.4		128	8.7	
Occupancy	838	7.2		783	6.6		55	7.0	
Furniture and equipment	852	7.3		865	7.2		(13)	(1.5)	
State shares tax	502	4.3		485	4.1		17	3.5	
Professional fees	476	4.1		488	4.1		(12)	(2.5)	
Directors fees	199	1.7		192	1.6		7	3.6	
FDIC assessments	236	2.0		239	2.0		(3)	(1.3)	
Telecommunications	200	1.7		185	1.6		15	8.1	
Amortization of core deposit intangible	276	2.4		326	2.7		(50)	(15.3)	
	356	3.1		498	4.2		(142)	(28.5)	

Automated teller machine and interchange

Other	1,237	10.6		1,513	12.7	(276)	(18.2)
Total non-interest expense	\$ 11,652	100.0 %		\$ 11,935	100.0 %	\$ (283)	(2.4) %

**FINANCIAL CONDITION**

Consolidated assets at September 30, 2013 were \$633.0 million which represented an increase of \$25.3 million from \$607.7 million at December 31, 2012.

The loan-to-deposit ratio is a key measurement of liquidity. Our loan-to-deposit ratio increased to 86.5 percent at September 30, 2013 as compared to 80.9 percent at December 31, 2012.

**INVESTMENTS**

All of our securities are available-for-sale and carried at estimated fair value. Available-for-sale securities are reported on the consolidated balance sheet at fair value with offsetting adjustments to deferred taxes and accumulated other comprehensive income. The possibility of material price volatility in a changing interest rate environment is offset by the availability to the Corporation of restructuring the portfolio for gap positioning at any time through the securities classified as available-for-sale. As reflected in the Consolidated Statements of Changes in Stockholders' Equity, the impact of the fair value accounting was an unrealized loss, net of tax, on September 30, 2013 of \$163,000 compared to an unrealized gain, net of tax, on December 31, 2012 of \$2,046,000, which represents an unrealized loss, net of tax, of \$2,209,000 for the nine months ended September 30, 2013. The following table shows the amortized cost and estimated fair value of the investment securities as of the dates shown:

(In Thousands)	September 30, 2013 Amortized Cost	Estimated Fair Value
Obligation of U.S. Government Corporations and Agencies:		
Mortgage-backed	\$ 97,228	\$ 97,317
Other	47,710	47,008
Obligations of state and political subdivisions	34,910	34,795
Total debt securities	179,848	179,120
Marketable equity securities	2,062	2,544
Total investment securities AFS	\$ 181,910	\$ 181,664

(In Thousands)	December 31, 2012 Amortized Cost	Estimated Fair Value
Obligation of U.S. Government Corporations and Agencies:		
Mortgage-backed	\$ 98,938	\$ 100,977
Other	40,000	40,168
Obligations of state and political subdivisions	26,422	27,195
Total debt securities	165,360	168,340
Marketable equity securities	1,983	2,104
Total investment securities AFS	\$ 167,343	\$ 170,444

**LOANS**

The loan portfolio increased 6.0 percent from \$374.8 million at December 31, 2012 to \$397.2 million at September 30, 2013. The percentage distribution in the loan portfolio was 79.4 percent in real estate loans at \$315.4 million; 10.7 percent in commercial loans at \$42.6 million; 1.6 percent in consumer loans at \$6.2 million; and 8.3 percent in tax exempt loans at \$33.0 million.

The following table presents the breakdown of loans by type as of the date indicated:

(In Thousands)	September 30, 2013	December 31, 2012	Change Amount	%	%
Commercial, financial and agricultural	\$ 42,621	\$ 42,547	\$ 74	0.2	%
Tax-exempt	33,016	27,625	5,391	19.5	
Real estate	306,709	279,539	27,170	9.7	
Real estate construction	8,342	18,800	(10,458)	(55.6)	
Installment loans to individuals	6,231	5,986	245	4.1	
Add (deduct): Unearned discount	-	-	-	-	
Unamortized loan costs, net of fees	305	268	37	13.8	

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Gross loans	\$	397,224	\$	374,765	\$	22,459	6.0	%
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The following table presents the percentage distribution of loans by category as of the date indicated:



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	September 30, 2013	December 31, 2012
Commercial, financial and agricultural	10.7	% 11.4
Tax-exempt	8.3	7.4
Real estate	77.3	74.7
Real estate construction	2.1	5.0
Installment loans to individuals	1.6	1.5
Gross loans	100.0	% 100.0

**ALLOWANCE FOR LOAN LOSSES**

The allowance for loan losses was \$6.1 million at September 30, 2013, compared to \$5.7 million at September 30, 2012. This allowance equaled 1.54 percent and 1.58 percent of total loans, net of unearned income, as of September 30, 2013 and 2012, respectively. The loan loss reserve is analyzed quarterly and reviewed by the Bank's Board of Directors. No concentration or apparent deterioration in classes of loans or pledged collateral was evident. Delinquent loans, loan exceptions and certain large loans are addressed by the full Board no less than monthly to determine compliance with policies. Allowance for loan losses was considered adequate based on quarterly analysis. The following table presents a summary of the Bank's loan loss experience as of the dates indicated:

(In Thousands)	For the Nine Months Ended September 30,	
	2013	2012
Average Loans Outstanding during the period	\$ 378,204	\$ 351,754
Balance, beginning of year	\$ 6,186	\$ 5,383
Provision charged to operations	90	365
Loans charged off:		
Commercial, financial, and agricultural	(24)	-
Real estate mortgages	(90)	(42)
Installment loans to individuals	(56)	(38)
Recoveries:		
Commercial, financial, and agricultural	2	-
Real estate mortgages	6	12
Installment loans to individuals	14	14
Balance, end of period	\$ 6,128	\$ 5,694
Ratio of net charge-offs to average loans outstanding during the period	0.04	% 0.02

**NON-PERFORMING LOANS**

As of September 30, 2013, loans 30 to 89 days past due totaled \$2.6 million compared to \$2.2 million at December 31, 2012. Non-accrual loans totaled \$3.3 million at September 30, 2013 and \$3.2 million at December 31, 2012. The following table presents past due and non-accrual loans by loan type and in summary as of the dates indicated:

(In Thousands)	September 30, 2013	December 31, 2012
Commercial, financial and agricultural		
Days 30-89	\$ 19	\$ 69
Days 90 plus	-	-
Non-accrual	411	586
Real estate		

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Days 30-89	2,524	2,130
Days 90 plus	-	-
Non-accrual	2,829	2,594
Installment loans to individuals		
Days 30-89	35	17
Days 90 plus	-	-
Non-accrual	10	36
	\$ 5,828	\$ 5,432
Days 30-89	\$ 2,578	\$ 2,216
Days 90 plus	-	-
Non-accrual	3,250	3,216
	\$ 5,828	\$ 5,432
Troubled debt restructurings in compliance and not reported past due	\$ 847	\$ 860
Other real estate owned	\$ 12	\$ -

**DEPOSITS**

Total average deposits decreased by 2.0 percent from \$478.3 million at December 31, 2012 to \$468.6 million at September 30, 2013. Average savings deposits increased 10.0 percent to \$82.7 million at September 30, 2013 from \$75.2 million at December 31, 2012. Average interest bearing time deposit accounts decreased 9.2 percent from \$198.9 million at December 31, 2012 to \$180.7 million at September 30, 2013.

The average balances and average rate paid on deposits are summarized as follows:

(In Thousands)	September 30, 2013			December 31, 2012			Change Amount	%
	Balance	Average Rate		Balance	Average Rate			
Non-interest bearing	\$ 77,680	- %		\$ 80,268	- %		\$ (2,588)	(3.2) %
Savings	82,682	0.06		75,185	0.14		7,497	10.0
Now deposits	78,521	0.07		77,093	0.07		1,428	1.9
Money market deposits	49,031	0.16		46,854	0.20		2,177	4.6
Time deposits	180,658	1.15		198,895	1.44		(18,237)	(9.2)
Total deposits	\$ 468,572	0.48 %		\$ 478,295	0.65 %		\$ (9,723)	(2.0) %

**BORROWED FUNDS**

Average short-term borrowings, including securities sold under agreements to repurchase and day-to-day FHLB - Pittsburgh borrowings increased to \$70.4 million at September 30, 2013 from \$61.0 at December 31, 2012. Average long-term borrowings decreased \$1.7 million.

The average balances are summarized as follows:

(In Thousands)	September 30, 2013			December 31, 2012			Change Amount	%
	Amount	% Total		Amount	% Total			
Short-term borrowings:								
Securities sold under agreement to repurchase	\$ 69,551	94.4 %		\$ 61,023	92.4 %		\$ 8,528	14.0 %
Short-term borrowings, FHLB	851	1.2		-	-		851	-
U.S. Treasury tax and loan notes	-	-		-	-		-	-
Total short-term borrowings	70,402	95.5 %		61,023	92.4 %		9,379	15.4
Long-term borrowings, FHLB	3,286	4.5		5,000	7.6		(1,714)	(34.3)
Total borrowed funds	\$ 73,688	100.0 %		\$ 66,023	100.0 %		\$ 7,665	11.6 %

Short-term borrowings consisted of the following at September 30, 2013 and 2012:

(In Thousands)	September 30, 2013				
	Ending Balance	Weighted Average Balance	Maximum Month End Balance	Average Rate	
Securities sold under agreements to repurchase	\$ 83,759	\$ 69,551	\$ 83,759	0.28	%
Other short-term borrowings	9,400	851	9,400	0.25	%
U.S. Treasury tax and loan notes	-	-	-	0.00	%
Total	\$ 93,159	\$ 70,402	\$ 93,159	0.27	%

(In Thousands)	September 30, 2012				
	Ending Balance	Weighted Average Balance	Maximum Month End Balance	Average Rate	
Securities sold under agreements to repurchase	\$ 72,818	\$ 58,663	\$ 72,818	0.37	%

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Other short-term borrowings	-	-	-	0.00	%
U.S. Treasury tax and loan notes	-	-	-	0.00	%
Total	\$ 72,818	\$ 58,663	\$ 72,818	0.37	%

**LIQUIDITY**

Liquidity management is required to ensure that adequate funds will be available to meet anticipated and unanticipated deposit withdrawals, debt service payments, investment commitments, commercial and consumer loan demand, and ongoing operating expenses. Funding sources include principal repayments on loans, sale of assets, growth in time and core deposits, short and long-term borrowings, investment securities coming due, loan prepayments and repurchase agreements. Regular loan payments are a dependable source of funds, while the sale of investment securities, deposit growth and loan prepayments are significantly influenced by general economic conditions and the level of interest rates.

We manage liquidity on a daily basis. We believe that our liquidity is sufficient to meet present and future financial obligations and commitments on a timely basis. However, see potential liquidity risk factors at Item 1A Risk Factors and refer to Consolidated Statements of Cash Flows in this Form 10-Q.

**CAPITAL RESOURCES**

Capital continues to be a strength for the Bank. Capital is critical as it must provide growth, payment to shareholders, and absorption of unforeseen losses. The federal regulators provide standards that must be met.

As of September 30, 2013, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios.

Our actual consolidated capital amounts and ratios as of September 30, 2013 and December 31, 2012 are in the following table:

(In Thousands)	2013 Amount	Ratio		2012 Amount	Ratio	
<b>Total Capital (to Risk-weighted Assets)</b>						
Actual	\$ 70,935	20.6	%	\$ 67,823	19.6	%
For Capital Adequacy Purposes	27,575	8.0		27,745	8.0	
To Be Well-Capitalized	34,469	10.0		34,682	10.0	
<b>Tier I Capital (to Risk-weighted Assets)</b>						
Actual	\$ 66,387	19.3	%	\$ 63,429	18.3	%
For Capital Adequacy Purposes	13,787	4.0		13,873	4.0	
To Be Well-Capitalized	20,681	6.0		20,809	6.0	
<b>Tier I Capital (to Average Assets)</b>						
Actual	\$ 66,387	10.7	%	\$ 63,429	10.4	%
For Capital Adequacy Purposes	24,846	4.0		24,487	4.0	
To Be Well-Capitalized	31,057	5.0		30,608	5.0	

Our capital ratios are not materially different from those of the Bank.

**INTEREST RATE RISK MANAGEMENT**

Interest rate risk management involves managing the extent to which interest-sensitive assets and interest-sensitive liabilities are matched. Interest rate sensitivity is the relationship between market interest rates and earnings volatility due to the repricing characteristics of assets and liabilities. The Bank's net interest income is affected by changes in the level of market interest rates. In order to maintain consistent earnings performance, the Bank seeks to manage, to

the extent possible, the repricing characteristics of its assets and liabilities.

One major objective of the Bank when managing the rate sensitivity of its assets and liabilities is to stabilize net interest income. The management of and authority to assume interest rate risk is the responsibility of the Bank's Asset/Liability Committee ("ALCO"), which is comprised of senior management and Board members. ALCO meets quarterly to monitor the ratio of interest sensitive assets to interest sensitive liabilities. The process to review interest rate risk management is a regular part of management of the Bank. Consistent policies and practices of measuring and reporting interest rate risk exposure, particularly regarding the treatment of noncontractual assets and liabilities, are in effect. In addition, there is an annual process to review the interest rate risk policy with the Board of Directors which includes limits on the impact to earnings from shifts in interest rates.

The ratio between assets and liabilities repricing in specific time intervals is referred to as an interest rate sensitivity gap. Interest rate sensitivity gaps can be managed to take advantage of the slope of the yield curve as well as forecasted changes in the level of interest rate changes.

To manage the interest sensitivity position, an asset/liability model called "gap analysis" is used to monitor the difference in the volume of the Bank's interest sensitive assets and liabilities that mature or reprice within given periods. A positive gap (asset sensitive) indicates that more assets reprice during a given period compared to liabilities, while a negative gap (liability sensitive) has the opposite effect. The Bank employs computerized net interest income simulation modeling to assist in quantifying interest rate risk exposure. This process measures and quantifies the impact on net interest income through varying interest rate changes and balance sheet compositions. The use of this model assists the ALCO to gauge the effects of the interest rate changes on interest sensitive assets and liabilities in order to determine what impact these rate changes will have upon our net interest spread.

At September 30, 2013, our cumulative gap positions and the potential earnings change resulting from a 400 basis point change in rates were both within the internal risk management guidelines.

In addition to gap analysis, the Bank uses earnings simulation to assist in measuring and controlling interest rate risk. The Bank also simulates the impact on net interest income of plus and minus 100, 200, 300 and 400 basis point rate shocks. The results of these theoretical rate shocks provide an additional tool to help manage the Bank's interest rate risk.

It is our opinion that the asset/liability mix and the interest rate risk associated with the balance sheet is within manageable parameters. Additionally, the Bank's Asset/Liability Committee meets quarterly with an investment consultant.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

In the normal course of conducting business activities, the Corporation 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.

No material changes in market risk occurred during the current period. A detailed discussion of market risk is provided in the Annual Report on Form 10-K for the period ended December 31, 2012.

### **Item 4. Controls and Procedures**

Our Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended), based on their evaluation of these controls and procedures as of the end of the period covered by this Report, were effective as of such date at the reasonable assurance level as discussed below to ensure that information required to be disclosed by us in the reports we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to our management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Our management, including the CEO and CFO, does not expect that our disclosure controls and internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. In addition, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls.

The CEO and CFO have evaluated the changes to our internal controls over financial reporting that occurred during our fiscal Quarter Ended September 30, 2013, as required by paragraph (d) Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, as amended, and have concluded that there were no changes that materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II Other Information**

### **Item 1. Legal Proceedings**

Management and the Corporation's legal counsel are not aware of any litigation that would have a material adverse effect on the consolidated financial position of the Corporation. There are no proceedings pending other than the ordinary routine litigation incident to the business of the Corporation and its subsidiary, First Columbia Bank & Trust Co. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation and the Bank 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, 2012, which could materially affect our business, financial condition or future results. At September 30, 2013 the risk factors of the Corporation have not changed materially from those in our Annual Report on Form 10-K, except as set forth below. 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.

The Dodd-Frank Wall Street Reform and Consumer Protection Act may affect our financial condition, results of operations, liquidity and stock price.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, was signed into law. The Dodd-Frank Act includes provisions affecting large and small financial institutions, including several provisions that will profoundly affect how community banks and bank holding companies will be regulated in the future. Among other things, these provisions relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, change the scope of federal deposit insurance coverage, and impose new capital requirements on bank holding companies. In addition, there is significant uncertainty about the full impact of the Dodd-Frank Act because many of its provisions require subsequent regulatory rule making.



The Dodd-Frank Act establishes the Bureau of Consumer Financial Protection as an independent entity within the Federal Reserve, which will be given authority to promulgate consumer protection regulations applicable to all entities offering financial services or products, including banks. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards, and pre-payments.

The Dodd-Frank Act contains numerous other provisions affecting financial institutions of all types, many of which may have an impact on the company's operating environment in substantial and unpredictable ways. Consequently, the Dodd-Frank Act is likely to affect our cost of doing business, it may limit or expand the activities in which the Company permissibly may engage, and it may affect the competitive balance within the company's industry and market areas.

The Dodd-Frank Act and the regulations to be adopted thereunder are expected to subject the company and other financial institutions to additional restrictions, oversight and costs that may have an adverse impact on its business, financial condition, results of operations or the price of the Company's common stock and the Company's ability to continue to conduct business consistent with historical practices.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Units) Purchased	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1 (July 1 - July 30, 2013) -	-	-	-	56,500
Month #2 (August 1 - August 31, 2013)	3,200	\$ 37.50	3,200	53,300
Month #3 (September 1 - September 30, 2013)	-	-	-	53,300

(1) This program was announced in 2009 and represents the third buy-back program. The Board of Directors approved the purchase of 200,000 shares. There was no expiration date associated with this program.

The Corporation did not sell any unregistered securities during the quarter ended June 30, 2013.

## Item 3. Defaults Upon Senior Securities

Not applicable.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None

## Item 6. Exhibits

3.1.1

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Amended and Restated Articles of Incorporation-incorporated by reference to Registrant's Current Report on Form 10-K, dated May 9, 2005, filed with the Commission on May 10, 2005.

- 3.2 Amended Bylaws-incorporated by reference to Registrant's Annual Report on Form 10-K, filed with the commission on March 26, 2010.
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer
- 32 Section 906 Certification of Principal Executive Officer and Principal Financial Officer

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this quarterly report on Form 10-Q for the period ended September 30, 2013, to be signed on its behalf by the undersigned thereunto duly authorized.

CCFNB BANCORP, INC.  
(Registrant)

/s/ Lance O. Diehl  
By

Lance O. Diehl  
President and CEO  
(Principal Executive Officer)  
Date: November 13, 2013

/s/ Jeffrey T. Arnold  
By

Jeffrey T. Arnold, CPA, CIA  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)  
Date: November 13, 2013