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CCFNB BANCORP INC  
Form 10-K  
March 09, 2006

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year-ended December 31, 2005

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934 [NO FEE REQUIRED]

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

Commission file Number: 0-19028

CCFNB BANCORP, INC.  
(Name of small business issuer in its charter)

PENNSYLVANIA  
(State or other jurisdiction of  
incorporation or organization)

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

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

17815  
(Zip Code)

Registrant's telephone number, including area code: (570) 784-4400

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par  
value \$1.25 per share.

Indicate by check mark if the Registrant is a well-known seasoned issuer, as  
defined in Rule 405 of the Securities Act. Yes \_\_\_\_\_ No   
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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 past 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 \_\_\_\_\_  
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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405  
of Regulation S-K is not contained herein, and will not be contained, to the  
best of Registrant's knowledge, in definitive proxy or information statements  
incorporated by reference in Part III of this Form 10-K or any amendment to this  
Form 10-K.

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Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No  X  
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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No  X  
 -----

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant based on the average of the bid and asked prices of \$27.75 at February 28, 2006, was \$34,820,728.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See the definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  X  
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As of February 28, 2006, the Registrant had outstanding 1,254,801 shares of its common stock, par value \$1.25 per share.

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## SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This annual report on Form 10-K, 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:

- possible changes in economic and business conditions that may affect the prevailing interest rates, the prevailing rates of inflation, or the amount of growth, stagnation, or recession in the global, U.S., and Northcentral Pennsylvania economies, the value of investments, collectibility of loans and the profitability of business entities;
- possible changes in monetary and fiscal policies, laws and regulations, and other activities of governments, agencies and similar organizations;
- the effects of easing of restrictions on participants in the financial services industry, such as banks, securities brokers and dealers, investment companies and finance companies, and changes evolving from the enactment of the Gramm-Leach-Bliley Act, which became effective in 2000, and attendant changes in matters and effects of competition in the financial services industry;
- the cost and other effects of legal proceedings, claims, settlements and judgments; and
- our ability to achieve the expected operating results related to our operations which depends on a variety of factors, including the continued growth of the markets in which we operate consistent with recent historical experience, and our ability to expand into new markets and to maintain profit margins in the face of pricing pressures.

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.

## ITEM 1. BUSINESS

## GENERAL

We are a registered financial holding company, bank holding company, and

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Pennsylvania business corporation, and are headquartered in Bloomsburg, Pennsylvania. We have one wholly-owned subsidiary which is Columbia County Farmers National Bank or referred to as the Bank. A substantial part of our business consists of the management and supervision of the Bank. Our principal source of income is dividends paid by the Bank. At December 31, 2005, we had approximately:

- \$231 million in total assets;
- \$154 million in loans;
- \$165 million in deposits; and
- \$ 29 million in stockholders' equity.

The Bank is a national banking association and member of the Federal Reserve System whose deposits are insured by the Bank Insurance Fund of the FDIC. The Bank is a full-service commercial bank providing a range of services and products, including time and demand deposit accounts, consumer, commercial and mortgage loans to individuals and small to medium-sized businesses in its Northcentral Pennsylvania market area. The Bank also operates a full-service trust department. Third-party brokerage services are also resident in the Bank's office in Lightstreet, Pennsylvania. At December 31, 2005, the Bank had 7 branch banking offices which are located in the Pennsylvania county of Columbia.

We consider our branch banking offices to be a single operating segment, because these branches have similar:

- economic characteristics,

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- products and services,
- operating processes,
- delivery systems,
- customer bases, and
- regulatory oversight.

We have not operated any other reportable operating segments in the 3-year period ended December 31, 2005. We have combined financial information for our third-party brokerage operation with our financial information, because this company does not meet the quantitative threshold for a reporting operating segment.

We hold a 50 percent interest in a local insurance agency. The name of this agency is Neighborhood Group, Inc. and trades under the fictitious name of Neighborhood Advisors (insurance agency). Through this joint venture, we sell insurance products and services. We account for this local insurance agency using the equity method of accounting.

As of December 31, 2005, we had 86 employees on a full-time equivalent basis. The Company and the Bank are not parties to any collective bargaining agreement and employee relations are considered to be good.

SUPERVISION AND REGULATION

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The following discussion sets forth the material elements of the regulatory framework applicable to us and the Bank and provides certain specific information. This regulatory framework is primarily intended for the protection of investors in our common stock, depositors at the Bank and the Bank Insurance Fund that insures bank deposits. To the extent that the following information describes statutory and regulatory provisions, it is qualified by reference to those provisions. A change in the statutes, regulations or regulatory policies applicable to us or the Bank may have a material effect on our business.

### INTERCOMPANY TRANSACTIONS

Various governmental requirements, including Sections 23A and 23B of the Federal Reserve Act and Regulation W of the Federal Reserve Board, limit borrowings by us from the Bank and also limit various other transactions between us and the Bank. For example, Section 23A of the Federal Reserve Act limits to no more than ten percent of its total capital the aggregate outstanding amount of the Bank's loans and other "covered transactions" with any particular non-bank affiliate (including a financial subsidiary) and limits to no more than 20 percent of its total capital the aggregate outstanding amount of the Bank's covered transactions with all of its affiliates (including financial subsidiaries). At December 31, 2005, approximately \$5.8 million was available for loans to us from the Bank. Section 23A of the Federal Reserve Act also generally requires that the Bank's loans to its non-bank affiliates (including financial subsidiaries) be secured, and Section 23B of the Federal Reserve Act generally requires that the Bank's transactions with its non-bank affiliates (including financial subsidiaries) be on arm's-length terms. Also, we, the Bank, and any financial subsidiary are prohibited from engaging in certain "tie-in" arrangements in connection with extensions of credit or provision of property or services.

### SUPERVISORY AGENCIES

As a national bank and member of the Federal Reserve System, the Bank is subject to primary supervision, regulation, and examination by the Office of the Comptroller of the Currency and secondary regulation by the FDIC. The Bank is subject to extensive statutes and regulations that significantly affect its business and activities. The Bank must file reports with its regulators concerning its activities and financial condition and obtain regulatory approval to enter into certain transactions. The Bank is also subject to periodic examinations by its regulators to ascertain compliance with various regulatory requirements. Other applicable statutes and regulations relate to insurance of deposits, allowable investments, loans, leases, acceptance of deposits, trust activities, mergers, consolidations, payment of dividends, capital requirements, reserves against deposits, establishment of branches and certain other facilities, limitations on loans to one borrower and loans to affiliated persons, activities of subsidiaries and other aspects of the business of banks. Recent federal legislation has instructed federal agencies to adopt standards or guidelines governing banks' internal controls, information systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation and benefits, asset quality, earnings and stock valuation, and other matters. The federal banking agencies have great flexibility in implementing standards on asset quality, earnings, and stock valuation. Regulatory authorities have broad flexibility to initiate proceedings designed to prohibit banks from engaging in unsafe and unsound banking practices.

We and the Bank are also affected by various other governmental requirements and regulations, general economic conditions, and the fiscal and monetary policies of the federal government and the Federal Reserve Board. The monetary policies of the Federal Reserve Board influence to a significant extent the overall growth of loans, leases, investments, deposits, interest rates charged on loans, and interest rates paid on deposits. The nature and impact of

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future changes in monetary policies are often not predictable.

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We are subject to the jurisdiction of the SEC for matters relating to the offering and sale of our securities. We are also subject to the SEC's rules and regulations relating to periodic reporting, insider trader reports and proxy solicitation materials. Our common stock is not listed for quotation of prices on The NASDAQ Stock Market or any other nationally-recognized stock exchange. However, daily bid and asked price quotations are maintained on the interdealer electronic bulletin board system.

### SUPPORT OF THE BANK

Under current Federal Reserve Board policy, we are expected to act as a source of financial and managerial strength to the Bank by standing ready to use available resources to provide adequate capital funds to the Bank during periods of financial adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting the Bank. The support expected by the Federal Reserve Board may be required at times when we may not have the resources or inclination to provide it.

If a default occurred with respect to the Bank, any capital loans to the Bank from us would be subordinate in right of payment to payment of the Bank depositors and certain of its other obligations.

### LIABILITY OF COMMONLY CONTROLLED BANKS

The Bank can be held liable for any loss incurred, or reasonably expected to be incurred, by the FDIC in connection with:

- the default of a commonly controlled FDIC-insured depository institution or
- any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default.

"Default" generally is defined as the appointment of a conservator or receiver, and "in danger of default" generally is defined as the existence of certain conditions indicating that a default is likely to occur in the absence of regulatory assistance.

### DEPOSITOR PREFERENCE STATUTE

In the "liquidation or other resolution" of the Bank by any receiver, federal legislation provides that deposits and certain claims for administrative expenses and employee compensation against the Bank are afforded a priority over the general unsecured claims against the Bank, including federal funds and letters of credit.

### ALLOWANCE FOR LOAN LOSSES

Commercial loans and commercial real estate loans comprised 34.0 percent of our total consolidated loans as of December 31, 2005. Commercial loans are typically larger than residential real estate loans and consumer loans. Because our loan portfolio contains a significant number of commercial loans and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in nonperforming loans. An increase in nonperforming loans could result in a loss of earnings

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from these loans and an increase in the provision for loan losses and loan charge-offs.

We maintain an allowance for loan losses to absorb any loan losses based on, among other things, our historical experience, an evaluation of economic conditions, and regular reviews of any delinquencies and loan portfolio quality. We cannot assure you that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the allowance for loan losses will not be required. Additions to the allowance for loan losses would result in a decrease in our net income and, possibly, our capital.

In evaluating our allowance for loan losses, we divide our loans into the following categories:

- commercial,
- real estate mortgages,
- consumer, and
- unallocated.

We evaluate some loans as a group and some individually. We use the following criteria in choosing loans to be evaluated individually:

- by risk profile, and
- by past due status.

After our evaluation of these loans, we allocate portions of our allowance for loan losses to categories of loans based upon the following considerations:

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- historical trends,
- economic conditions, and
- any known deterioration.

We use a self-correcting mechanism to reduce differences between estimated and actual losses. We will, on an annual basis, weigh our loss experience among the various categories and reallocate the allowance for loan losses.

For a more in-depth presentation of our allowance for loan losses and the components of this allowance, please refer to Item 7 of this report under Management's Discussion and Analysis of Financial Condition and Results of Operations at "Non-Performing Assets," "Allowance for Loan Losses and Related Provision," and "Summary of Loan Loss Experience," as well as Note 4, Item 8 to this report.

### SOURCES OF FUNDS

GENERAL. Our primary source of funds is the cash flow provided by our investing activities, including principal and interest payments on loans and mortgage-backed and other securities. Our other sources of funds are provided by operating activities (primarily net income) and financing activities, including borrowings and deposits.

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DEPOSITS. We offer a variety of deposit accounts with a range of interest rates and terms. We currently offer passbook and statement savings accounts, NOW accounts, money market accounts, demand deposit accounts and certificates of deposit. The flow of deposits is influenced significantly by general economic conditions, changes in prevailing interest rates, pricing of deposits and competition. Our deposits are primarily obtained from areas surrounding our banking offices. We rely primarily on marketing, new products, service and long-standing relationships with customers to attract and retain these deposits. At December 31, 2005, our deposits totaled \$165 million. Of the total deposit balance, \$10 million or 6.1 percent, represent Individual Retirement Accounts and \$26 million or 15.8 percent represent certificates of deposit in amounts of \$100,000 or more.

When we determine the levels of our deposit rates, consideration is given to local competition, yields of U.S. Treasury securities and the rates charged for other sources of funds. We have maintained a high level of core deposits, which has contributed to our low cost of funds. Core deposits include savings, money market, NOW and demand deposit accounts, which, in the aggregate, represented 50.5 percent of total deposits at December 31, 2004 and 49.7 percent of total deposits at December 31, 2005.

We are not dependent for deposits nor exposed by loan concentrations to a single customer or to a small group of customers the loss of any one or more of which would have a materially adverse effect on our financial condition.

For a further discussion of our deposits, please refer to Item 7 of this report under Management's Discussion and Analysis of Financial Condition and Results of Operations at "Deposits and Borrowed Funds," as well as Note 7, Item 8 to this report.

### CAPITAL REQUIREMENTS

We are subject to risk-based capital requirements and guidelines imposed by the Federal Reserve Board, which are substantially similar to the capital requirements and guidelines imposed by the Comptroller of the Currency on the Bank. For this purpose, a bank's or bank holding company's assets and certain specified off-balance sheet commitments are assigned to four risk categories, each weighted differently based on the level of credit risk that is ascribed to those assets or commitments. In addition, risk-weighted assets are adjusted for low-level recourse and market-risk equivalent assets. A bank's or bank holding company's capital, in turn, includes the following tiers:

- core ("Tier 1") capital, which includes common equity, non-cumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less goodwill, certain identifiable intangible assets, and certain other assets; and
- supplementary ("Tier 2") capital, which includes, among other items, perpetual preferred stock not meeting the Tier 1 definition, mandatory convertible securities, subordinated debt and allowances for loan and lease losses, subject to certain limitations, less certain required deductions.

We, like other bank holding companies, are required to maintain Tier 1 and "Total Capital" (the sum of Tier 1 and Tier 2 capital, less certain deductions) equal to at least four percent and eight percent of our total risk-weighted assets (including certain off-balance sheet items, such as unused lending commitments and standby letters of credit), respectively. At December 31, 2005, we met both requirements, with Tier 1 and Total Capital equal to 19.2 percent and 20.3 percent of total risk-weighted assets.



The Federal Reserve Board has adopted rules to incorporate market and interest rate risk components into their risk-based capital standards. Under these market-risk requirements, capital will be allocated to support the amount of market risk related to a financial institution's ongoing trading activities.

The Federal Reserve Board also requires bank holding companies to maintain a minimum "Leverage Ratio" (Tier 1 capital to adjusted total assets) of three percent if the bank holding company has the highest regulatory rating and meets certain other requirements, or of three percent plus an additional cushion of at least one to two percentage points if the bank holding company does not meet these requirements. At December 31, 2005, our leverage ratio was 12.7 percent.

The Federal Reserve Board may set capital requirements higher than the minimums noted above for holding companies whose circumstances warrant it. For example, bank holding companies experiencing or anticipating significant growth may be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the Federal Reserve Board has indicated that it will consider a "Tangible Tier 1 Leverage Ratio" (deducting all intangibles) and other indications of capital strength in evaluating proposals for expansion or new activities, or when a bank holding company faces unusual or abnormal risk. The Federal Reserve Board has not advised us of any specific minimum leverage ratio applicable to us.

The Bank is subject to similar risk-based capital and leverage requirements adopted by the Comptroller of the Currency. The Bank was in compliance with the applicable minimum capital requirements as of December 31, 2005. The Comptroller of the Currency has not advised the Bank of any specific minimum leverage ratio applicable to the Bank.

Failure to meet capital requirements could subject the Bank to a variety of enforcement remedies, including the termination of deposit insurance by the FDIC, and to certain restrictions on its business. The Federal Deposit Insurance Corporation Improvements Act of 1991 ("FDICIA"), among other things, identifies five capital categories for insured banks - well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized - and requires federal bank regulatory agencies to implement systems for "prompt corrective action" for insured banks that do not meet minimum capital requirements based on these categories. The FDICIA imposed progressively more restrictive constraints on operations, management, and capital distributions, depending on the category in which an institution is classified. Unless a bank is well capitalized, it is subject to restrictions on its ability to offer brokered deposits, on "pass-through" insurance coverage for certain of its accounts, and on certain other aspects of its operations. FDICIA generally prohibits a bank from paying any dividend or making any capital distribution or paying any management fee to its holding company if the bank would thereafter be undercapitalized. An undercapitalized bank is subject to regulatory monitoring and may be required to divest itself of or liquidate subsidiaries. Holding companies of such institutions may be required to divest themselves of such institutions or divest themselves of or liquidate other affiliates. An undercapitalized bank must develop a capital restoration plan, and its parent bank holding company must guarantee the bank's compliance with the plan up to the lesser of five percent of the bank's assets at the time it became undercapitalized or the amount needed to comply with the plan. Critically undercapitalized institutions are prohibited from making payments of principal and interest on subordinated debt and are generally subject to the mandatory

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appointment of a conservator or receiver.

Rules adopted by the Comptroller of the Currency under FDICIA provide that a national bank is deemed to be well capitalized if the bank has a total risk-based capital ratio of ten percent or greater, a Tier 1 risk-based capital ratio of six percent or greater, and a leverage ratio of five percent or greater and the institution is not subject to a written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific level of any capital measure. As of December 31, 2005, the Bank was well-capitalized, based on the prompt corrective action ratios and guidelines described above. It should be noted, however, that a bank's capital category is determined solely for the purpose of applying the Comptroller of the Currency's prompt corrective action regulations, and that the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects.

### BROKERED DEPOSITS

Under FDIC regulations, no FDIC-insured bank can accept brokered deposits unless it (1) is well capitalized, or (2) is adequately capitalized and receives a waiver from the FDIC. In addition, these regulations prohibit any bank that is not well capitalized from paying an interest rate on brokered deposits in excess of three-quarters of one percentage point over certain prevailing market rates. As of December 31, 2005, the Bank held no brokered deposits.

### DIVIDEND RESTRICTIONS

We are a legal entity separate and distinct from the Bank. In general, under Pennsylvania law, we cannot pay a cash dividend if such payment would render us insolvent. Our revenues consist primarily of dividends paid by the Bank. The National Bank Act limits the amount of dividends the Bank can pay to us without regulatory approval. The Bank may declare and pay dividends to us to the lesser of:

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- the level of undivided profits, and
- absent regulatory approval, an amount not in excess of net income combined with retained net income for the preceding two years.

At December 31, 2005, approximately \$2,274,585 was available for payment of dividends to us.

In addition, federal bank regulatory authorities have authority to prohibit the Bank from engaging in an unsafe or unsound practice in conducting its business. Depending upon the financial condition of the bank in question, the payment of dividends could be deemed to constitute an unsafe or unsound practice. The ability of the Bank to pay dividends in the future is currently influenced, and could be further influenced, by bank regulatory policies and capital guidelines.

### DEPOSIT INSURANCE ASSESSMENTS

The deposits of the Bank are insured up to regulatory limits by the FDIC and, accordingly, are subject to deposit insurance assessments to maintain the Bank Insurance Fund ("BIF") administered by the FDIC. The FDIC has adopted regulations establishing a permanent risk-related deposit insurance assessment system. Under this system, the FDIC places each insured bank in one of nine risk

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categories based on the bank's capitalization and supervisory evaluations provided to the FDIC by the institution's primary federal regulator. An insured bank's insurance assessment rate is then determined by the risk category in which it is classified by the FDIC.

In the light of the recent favorable financial situation of the federal deposit insurance funds and the recent low number of depository institution failures, the annual insurance premiums on bank deposits insured by the BIF vary between \$0.00 per \$100 of deposits for banks classified in the highest capital and supervisory evaluation categories to \$0.27 per \$100 of deposits for banks classified in the lowest capital and supervisory evaluation categories. BIF assessment rates are subject to semi-annual adjustment by the FDIC within a range of up to five basis points without public comment. The FDIC also possesses authority to impose special assessments from time to time.

The Deposit Insurance Funds Act provides for assessments to be imposed on insured depository institutions with respect to deposits insured by the BIF (in addition to assessments currently imposed on depository institutions with respect to BIF-insured deposits) to pay for the cost of Financing Corporation ("FICO") funding. The FICO assessments are adjusted periodically to reflect changes in the assessment bases of the FDIC insurance funds and do not vary depending upon a depository institution's capitalization or supervisory evaluations. In 2005, the Bank paid FICO assessments of \$23,091.

### INTERSTATE BANKING AND BRANCHING

Bank holding companies (including bank holding companies that also are financial holding companies) are required to obtain the prior approval of the Federal Reserve Board before acquiring more than five percent of any class of voting stock of any non-affiliated bank. Pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the "Interstate Banking and Branching Act"), a bank holding company may acquire banks located in states other than its home state without regard to the permissibility of such acquisitions under state law, but subject to any state requirement that the bank has been organized and operating for a minimum period of time, not to exceed five years, and the requirement that the bank holding company, after the proposed acquisition, controls no more than 10.0 percent of the total amount of deposits of insured depository institutions in the United States and no more than 30.0 percent or such lesser or greater amount set by state law of such deposits in that state.

Subject to certain restrictions, the Interstate Banking and Branching Act also authorizes banks to merge across state lines to create interstate banks. The ability of banks to acquire branch offices through purchases or openings of other branches is contingent, however, on the host state having adopted legislation "opting in" to those provisions of Riegle-Neal. In addition, the ability of a bank to merge with a bank located in another state is contingent on the host state not having adopted legislation "opting out" of that provision of Riegle-Neal. Pennsylvania has opted in to all of these provisions upon the condition that another host state has similar or reciprocal requirements. As of the date of this report, we are not contemplating any interstate acquisitions of a bank or a branch office.

### CONTROL ACQUISITIONS

The Change in Bank Control Act prohibits a person or group of persons from acquiring "control" of a bank holding company, unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of ten percent or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as we, would, under the circumstances set forth in the presumption, constitute

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acquisition of control of the bank holding company.

In addition, a company is required to obtain the approval of the Federal Reserve Board under the Bank Holding Company Act before acquiring 25 percent (five percent in the case of an acquirer that is a bank holding company) or more of any class of outstanding

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common stock of a bank holding company, such as we, or otherwise obtaining control or a "controlling influence" over that bank holding company.

### PERMITTED NON-BANKING ACTIVITIES

The Federal Reserve Board permits us or our subsidiaries to engage in nonbanking activities that are so closely related to banking or managing or controlling banks as to be a proper incident thereto. The Federal Reserve Board requires us to serve as a source of financial and managerial strength to the Bank and not to conduct our operations in an unsafe or unsound manner. Whenever the Federal Reserve Board believes an activity that we perform or our control of a nonbank subsidiary, other than a nonbank subsidiary of the Bank, constitutes a serious risk to the financial safety, soundness or stability of the Bank and is inconsistent with sound banking principles or the purposes of the federal banking laws, the Federal Reserve Board may require us to terminate that activity or to terminate control of that subsidiary.

### COMMUNITY REINVESTMENT ACT

The Community Reinvestment Act of 1977, as amended ("CRA"), and the regulations promulgated to implement the CRA, are designed to create a system for bank regulatory agencies to evaluate a depository institution's record in meeting the credit needs of its community. The Bank received a "satisfactory" rating in its last CRA examination which was held in 2002.

### FINANCIAL SERVICES MODERNIZATION

We must comply with the Gramm-Leach-Bliley Act of 1999 (the "GLB Act") in the conduct of our operations. The GLB Act eliminates the restrictions placed on the activities of banks and bank holding companies and creates two new structures, financial holding companies and financial subsidiaries. We and the Bank are now allowed to provide a wider array of financial services and products that were reserved only for insurance companies and securities firms. In addition, we can now affiliate with an insurance company and a securities firm. We can elect to become a financial holding company. A financial holding company has authority to engage in activities referred to as "financial activities" that are not permitted to bank holding companies. A financial holding company may also affiliate with companies that are engaged in financial activities. A "financial activity" is an activity that does not pose a safety and soundness risk and is financial in nature, incidental to an activity that is financial in nature, or complimentary to a financial activity.

### PRIVACY

Title V of the GLB Act creates a minimum federal standard of privacy by limiting the instances which we and the Bank may disclose nonpublic personal information about a consumer of our products or services to nonaffiliated third parties. The GLB Act distinguishes "consumers" from "customers" for purposes of the notice requirements imposed by this Act. We are required to give a "consumer" a privacy notice only if we intend to disclose nonpublic personal

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information about the consumer to a nonaffiliated third party. However, by contrast, we are required to give a "customer" a notice of our privacy policy at the time of the establishment of a customer relationship and then annually, thereafter during the continuation of the customer relationship.

### TERRORIST ACTIVITIES

The Office of Foreign Assets Control ("OFAC") of the Department of the Treasury has, and will, send us and our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, the Bank must freeze such account, file a suspicious activity report and notify the Federal Bureau of Investigation. The Bank has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications.

### THE USA PATRIOT ACT

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism ("USA PATRIOT") Act of 2001 was enacted by Congress as a result of the terrorist attack on the World Trade Center on September 11, 2001. The Congress is deliberating on amendments to the USA Patriot Act, none of these proposed amendments would have a substantial effect on our banking operations. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and "know your customer" standards in their dealings with foreign financial institutions and foreign customers.

### SUBPRIME AND PREDATORY LENDING

The Federal Reserve Board has issued regulations which implement the Home Ownership and Equity Protection Act ("HOEPA"). This Act imposes additional disclosure requirements and certain substantive limitations on certain mortgage loans with

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rates or fees above specified levels. The regulations lower the rate levels that trigger the application of HOEPA and include additional fees in the calculation of the fee amount that triggers HOEPA. The loans that the Bank currently makes are generally below the rate and fee levels that trigger HOEPA.

The Bank must also comply with a Pennsylvania law, Act 55 of 2001, the Mortgage Bankers and Brokers and Consumer Equity Protection Act. This Act addresses what is known as "predatory lending," among other things, and is applicable to the Bank's closed-end home equity mortgage loans, involving property located in Pennsylvania, in an amount less than \$100.0 thousand made at a "high cost," which is generally the rate and point triggers in the HOEPA. Those HOEPA triggers are:

- An annual percentage rate exceeding 8.00 percentage points above comparable term U.S. Treasury securities for first-lien mortgages and 10 percent for subordinate-lien mortgages; and/or
- Total points and fees payable by the consumer at or before closing that exceed the greater of 8.0 percent of the total loan amount or \$499. The \$499 is adjusted annually by the annual percentage change in the Consumer Price Index.

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### SALES OF INSURANCE

Our federal banking regulatory agencies have issued consumer protection rules with respect to the retail sale of insurance products by us, the Bank, or a subsidiary or joint venture of us or the Bank. These rules generally cover practices, solicitations, advertising or offers of any insurance product by a depository institution or any person that performs such activities at an office of, or on behalf of, us or the Bank. Moreover, these rules include specific provisions relating to sales practices, disclosures and advertising, the physical separation of banking and nonbanking activities and domestic violence discrimination.

### CORPORATE GOVERNANCE

The Sarbanes-Oxley Act of 2002 ("SOX") has substantially changed the manner in which public companies govern themselves and how the accounting profession performs its statutorily required audit function. SOX makes structural changes in the way public companies make disclosures and strengthens the independence of auditors and audit committees. SOX requires direct responsibility of senior corporate management, namely the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), for establishing and maintaining an adequate internal control structure and procedures for financial reporting and disclosure by public companies.

Under SOX, audit committees will be primarily responsible for the appointment, compensation and oversight of the work of their auditors. The independence of the members of the audit committee is assured by barring members who accept consulting fees from the company or are affiliated with the company other than in their capacity as members of the board of directors.

SOX prohibits insider trades during pension fund blackout periods and requires prompt disclosure of insider transactions in company stock, which must be reported by the second business day following an insider transaction. Furthermore, SOX established a new federal crime of securities fraud with substantial penalties.

As a result of SOX, the costs to enhance our corporate governance regime and financial reporting controls and procedures, was approximately \$33,000 in 2005 paid to an outside consultant. In addition to these third party costs, an extensive amount of personnel time was applied to Management of the project. There were no costs associated with SOX in 2004.

### THE BANK

The Bank's legal headquarters are located at 232 East Street, Bloomsburg, Columbia County, Pennsylvania 17815. The Bank is a locally-owned and managed community bank that seeks to provide personal attention and professional financial assistance to its customers. The Bank serves the needs of individuals and small to medium-sized businesses. The Bank's business philosophy includes offering direct access to its President and other officers and providing friendly, informed and courteous service, local and timely decision making, flexible and reasonable operating procedures and consistently-applied credit policies.

The Bank solicits small and medium-sized businesses located primarily within the Bank's market area that typically borrow in the \$25,000 to \$1.0 million range. In the event that certain loan requests may exceed the Bank's lending limit to any one customer, the Bank seeks to arrange such loans on a participation basis with other financial institutions.

### MARKETING AREA

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The Bank's primary market area is Columbia County, a 484 square mile area located in Northcentral Pennsylvania with a population of approximately 64,157 based on 2000 census data. The Town of Bloomsburg is the County's largest municipality and its center of industry and commerce. Bloomsburg has a population of approximately 12,375 based on 2000 census data, and is the county seat. Berwick, located on the eastern boundary of the County, is the second largest municipality, with a 2000 census data population

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of approximately 10,774. The Bank currently serves its market area through seven branch offices located in Bloomsburg, Benton, Buckhorn, Lightstreet, Millville, Orangeville and South Centre, Columbia County.

The Bank competes with other depository institutions in Columbia County. The Bank's major competitors are: First National Bank of Berwick; PNC Bank, M & T Bank, First Columbia Bank and Trust Company of Bloomsburg, Pennsylvania, as well as several credit unions.

The Bank's extended market area includes the adjacent Pennsylvania counties of Luzerne, Montour, Northumberland, Schuylkill and Sullivan.

### AVAILABLE INFORMATION

We file reports, proxy, information statements and other information electronically with the SEC through the Electronic Data Gathering Analysis and Retrieval filing system. You may read and copy any materials that we file with the SEC at the SEC's Public Reference Room located at 450 5th Street, N.W., Washington, DC 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC. The SEC's website address is <http://www.sec.gov>. Our website address is <http://www.ccfnb.com>. Copies of our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC may be obtained without charge by writing to CCFNB Bancorp, Inc., 232 East Street, Bloomsburg, PA 17815; Attn: Ms. Virginia D. Kocher, Treasurer.

### ITEM 1A. RISK FACTORS

ADVERSE CHANGES IN THE ECONOMIC CONDITIONS IN OUR MARKET AREA COULD MATERIALLY AND NEGATIVELY AFFECT OUR BUSINESS.

Substantially all of our business is with consumers and small to mid-sized companies located within Columbia, Luzerne and Montour Counties, Pennsylvania. Our business is directly impacted by factors such as economic, political and market conditions, broad trends in industry and finance, legislative and regulatory changes, changes in government monetary and fiscal policies and inflation, all of which are beyond our control. A deterioration in economic conditions, whether caused by national or local concerns, in particular an economic slowdown in northcentral Pennsylvania, could result in the following consequences, any of which could materially harm our business:

- customers' credit quality may deteriorate;

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- loan delinquencies may increase;
- problem assets and foreclosures may increase;
- demand for our products and services may decrease;
- competition for low cost or non-interest bearing deposits may increase; and
- collateral securing loans may decline in value.

COMPETITIVE PRESSURES FROM FINANCIAL SERVICES COMPANIES AND OTHER COMPANIES OFFERING BANKING SERVICES COULD NEGATIVELY IMPACT OUR BUSINESS.

We conduct banking operations primarily in northcentral Pennsylvania. Increased competition in the Bank's market may result in reduced loans and deposits, high customer turnover, and lower net interest rate margins. Ultimately, the Bank may not be able to compete successfully against current and future competitors. Many competitors in the Bank's market area, including regional banks, other community-focused depository institutions and credit unions, offer the same banking services as the Bank offers. The Bank also faces competition from many other types of financial institutions, including without limitation, finance companies, brokerage firms, insurance companies, mortgage banks and other financial intermediaries. These competitors often have greater resources affording them the competitive advantage of maintaining numerous retail locations and ATMs and conducting extensive promotional and advertising campaigns. Moreover, our credit union competitors pay no corporate taxes and can, therefore, more aggressively price many products and services.

CHANGES IN INTEREST RATES COULD REDUCE OUR INCOME AND CASH FLOWS.

The Bank's income and cash flows and the value of its assets and liabilities depend to a great extent on the difference between the income earned on interest-earning assets such as loans and investment securities, and the interest expense paid on interest-bearing liabilities such as deposits and borrowings. These rates are highly sensitive to many factors which are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board.

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Changes in monetary policy, including changes in interest rates, will influence the origination of loans and investment securities and the amounts paid on deposits. If the rates of interest the Bank pays on its deposits and other borrowings increases more than the rates of interest the Bank earns on its loans and other investments, the Bank's net interest income, and therefore our earnings, could be adversely affected. The Bank's earnings could also be adversely affected if the rates on its loans or other investments fall more quickly than those on its deposits and other borrowings.

SIGNIFICANT INCREASES IN INTEREST RATES MAY AFFECT CUSTOMER LOAN DEMAND AND PAYMENT HABITS.

Significant increases in market interest rates, or the perception that an increase may occur, could adversely impact the Bank's ability to generate new loans. An increase in market interest rates may also adversely impact the ability of adjustable rate borrowers to meet repayment obligations, thereby causing nonperforming loans and loan charge-offs to increase in these mortgage products.



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IF THE BANK'S LOAN GROWTH EXCEEDS THAT OF ITS DEPOSIT GROWTH, THEN THE BANK MAY BE REQUIRED TO OBTAIN HIGHER COST SOURCES OF FUNDS.

Our growth strategy depends upon generating an increasing level of loans at the Bank while maintaining a low level of loan losses for the Bank. As the Bank's loans grow, it is necessary for the Bank's deposits to grow at a comparable pace in order to avoid the need for the Bank to obtain other sources of loan funds at higher costs. If the Bank's loan growth exceeds the deposit growth, the Bank may have to obtain other sources of funds at higher costs.

IF THE BANK'S ALLOWANCE FOR LOAN LOSSES IS NOT ADEQUATE TO COVER ACTUAL LOAN LOSSES, ITS EARNINGS MAY DECLINE.

The Bank maintains an allowance for loan losses to provide for loan defaults and other classified loans due to unfavorable characteristics. The Bank's allowance for loan losses may not be adequate to cover actual loan losses, and future provisions for loan losses could materially and adversely affect our operating results. The Bank's allowance for loan loss is based on prior experience, as well as an evaluation of risks in the current portfolio. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, change in borrowers' creditworthiness, and the value of collateral securing loans and leases that may be beyond the Bank's control, and these losses may exceed our current estimates. The OCC (Office of the Comptroller of the Currency) reviews the Bank's loans and allowance for loan losses and may require the Bank to increase its allowance. While we believe that the Bank's allowance for loan losses is adequate to cover current losses, we cannot assure that the Bank will not further increase the allowance for loan losses or that the OCC will not require the Bank to increase the allowance. Either of these occurrences could materially affect our earnings.

ADVERSE CHANGES IN THE MARKET VALUE OF SECURITIES AND INVESTMENTS THAT WE MANAGE FOR OTHERS MAY NEGATIVELY IMPACT THE GROWTH LEVEL OF THE BANK'S NON-INTEREST INCOME.

Our company provides a broad range of trust and investment management services for estates, trusts, agency accounts, and individual and employer sponsored retirement plans. The market value of the securities and investments managed by the Bank may decline due to factors outside the Bank's control. Any such adverse changes in the market value of the securities and investments could negatively impact the growth of the non-interest income generated from providing these services.

THE BANK'S BRANCH LOCATIONS MAY BE NEGATIVELY AFFECTED BY CHANGES IN DEMOGRAPHICS.

We and the Bank have strategically selected locations for bank branches based upon regional demographics. Any changes in regional demographics may impact the Bank's ability to reach or maintain profitability at its branch locations. Changes in regional demographics may also affect the perceived benefits of certain branch locations and management may be required to reduce the number of locations of its branches.

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CHANGES IN THE REGULATORY ENVIRONMENT MAY ADVERSELY AFFECT THE BANK'S BUSINESS.

The banking industry is highly regulated and the Bank is subject to extensive state and federal regulation, supervision, and legislation. The Bank

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is subject to regulation and supervision by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission. These laws and regulations may change from time to time and may limit our ability to offer new products and services, obtain financing, attract deposits, and originate loans. Any changes to these laws and regulations may adversely affect loan demand, credit quality, consumer spending and saving habits, interest rate margins, FDIC assessments, and operating expenses. Therefore, our results of operations and financial condition may be materially negatively impacted by such changes.

TRAINING AND TECHNOLOGY COSTS, AS WELL AS PRODUCT DEVELOPMENT AND OPERATING COSTS, MAY EXCEED OUR EXPECTATIONS AND NEGATIVELY IMPACT OUR PROFITABILITY.

The financial services industry is constantly undergoing technological changes in the types of products and services provided to customers to enhance customer convenience. Our future success will depend upon our ability to address the changing technological needs of our customers. We have invested a substantial amount of resources to update our technology and train the management team. This investment in technology and training seeks to increase efficiency in the management team's performance and improve accessibility to customers. We are also investing in the expansion of bank branches, improvement of operating systems, and the development of new marketing initiatives. The costs of implementing the technology, training, product development, and marketing costs may exceed our expectations and negatively impact our results of operations and profitability.

IF WE FAIL TO MAINTAIN AN EFFECTIVE SYSTEM OF INTERNAL CONTROLS, WE MAY NOT BE ABLE TO ACCURATELY REPORT OUR FINANCIAL RESULTS OR PREVENT FRAUD.

If we fail to maintain an effective system of internal controls; fail to correct any issues in the design or operating effectiveness of internal controls over financial reporting; or fail to prevent fraud, our shareholders could lose confidence in our financial reporting, which could harm our business and the trading price of our common stock.

THE LOSS OF ONE OR MORE OF OUR KEY PERSONNEL MAY MATERIALLY AND ADVERSELY AFFECT OUR PROSPECTS.

We depend on the services of our President and Chief Executive Officer, Lance O. Diehl, and a number of other key management personnel. The loss of Mr. Diehl's services or that of other key personnel could materially and adversely affect our results of operations and financial condition. Our success also depends, in part, on our ability to attract and retain additional qualified management personnel. Competition for such personnel is strong in the banking industry and we may not be successful in attracting or retaining such personnel due to our geographic location and prevailing salary levels in our market area.

### ITEM 2. PROPERTIES

Our corporate headquarters are located at 232 East Street, Bloomsburg, Pennsylvania. We own this facility which has approximately 11,686 square feet. The Bank's legal or registered office is also at 232 East Street, Bloomsburg, Pennsylvania. Our remaining banking centers are described as follows: We own all of the banking centers except Buckhorn, which we lease. The Buckhorn banking center is under a five year lease, begun in 2003, with two 5 year options with Wal-Mart.

| Location | Approximate<br>Square Footage | Use   |
|----------|-------------------------------|-------|
| -----    | -----                         | ----- |

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|                    |        |  |
|--------------------|--------|--|
| Orangeville, PA    | 2,259  | Banking Services   |
| Benton, PA         | 4,672  | Banking Services   |
| South Centre, PA   | 3,868  | Banking Services   |
| Scott Township, PA | 16,500 | Banking Services, Corporate,<br>Credit, Financial Planning and<br>Operations |
| Millville, PA      | 2,520  | Banking Services   |
| Buckhorn, PA       | 693    | Banking Services (In Wal-Mart<br>Supercenter)                                |
| Berwick, PA        | 2,240  | Future Banking Services  |

We consider our facilities to be suitable and adequate for our current and immediate future purposes.

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### ITEM 3. LEGAL PROCEEDINGS

We and the Bank are not parties to any legal proceedings that could have any significant effect upon our financial condition or income. In addition, we and the Bank are not parties to any legal proceedings under federal and state environmental laws.

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

We had 772 stockholders of record not including individual participants in security position listings and 1,254,801 shares of common stock, par value of \$1.25 per share, the only authorized class of common stock, outstanding as of February 28, 2006. Our common stock trades under the symbol "CCFN." As of February 28, 2006, 5 firms were identified on the interdealer electronic bulletin board system as market makers in our common stock. The following information is reported by one of our market makers: Ferris, Baker Watts, Inc., Baltimore, MD. These quotations represent prices between buyers and sellers and do not include retail makeup, markdown or commission. They may not necessarily represent actual transactions. The high and low closing sale prices and dividends per share of our common stock for the four quarters of 2005 and 2004 are summarized in the following table.

| 2005:          | High (\$) | Low (\$) | Dividends<br>Declared (\$) |
|----------------|-----------|----------|----------------------------|
| -----          | -----     | -----    | -----                      |
| First quarter  | 27.50     | 27.05    | .18                        |
| Second quarter | 28.10     | 27.15    | .18                        |
| Third quarter  | 27.75     | 29.75    | .19                        |
| Fourth quarter | 27.75     | 29.00    | .19                        |

| 2004:         | High (\$) | Low (\$) | Dividends<br>Declared (\$) |
|---------------|-----------|----------|----------------------------|
| -----         | -----     | -----    | -----                      |
| First quarter | 29.50     | 28.00    | .17                        |

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|                |       |       |     |
|----------------|-------|-------|-----|
| Second quarter | 29.00 | 26.50 | .17 |
| Third quarter  | 31.25 | 27.50 | .18 |
| Fourth quarter | 31.00 | 27.10 | .18 |

We have paid cash dividends since 1983. It is our present intention to continue the dividend payment policy, although the payment of future dividends must necessarily depend upon earnings, financial position, appropriate restrictions under applicable law and other factors relevant at the time the Board of Directors considers any declaration of dividends.

The following table presents information on the shares of our common stock that we repurchased during the fourth quarter of 2005:

| CCFNB BANCORP, INC.<br>ISSUER PURCHASES OF EQUITY SECURITIES<br>MONTH | NUMBER OF<br>SHARES<br>PURCHASED | PRICE<br>PAID<br>PER<br>SHARE | NUMBER OF<br>SHARES<br>PURCHASED AS<br>PART OF<br>PUBLICLY<br>ANNOUNCED<br>PROGRAM | NUMBER OF<br>SHARES THAT<br>MAY YET BE<br>PURCHASED<br>UNDER THE<br>PROGRAM |
|---|----------------------------------|-------------------------------|--|---|
| 10/24/05-10/24/05   | 2,000                            | \$28.25                       | 2,000  | 68,000  |
| 11/04/05-11/04/05   | 2,000                            | \$28.75                       | 2,000  | 66,000  |
| 12/06/05-12/06/05   | 2,000                            | \$28.00                       | 2,000  | 64,000  |
| TOTAL   | 6,000                            |                               | 6,000  |   |

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### ITEM 6. SELECTED FINANCIAL DATA

CCFNB BANCORP, INC.  
SELECTED CONSOLIDATED FINANCIAL SUMMARY  
AS OF DECEMBER 31,

| (DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA AND RATIOS) | 2005      | 2004      | 2003      |
|--|-----------|-----------|-----------|
| <b>INCOME STATEMENT DATA:</b>                            |           |           |           |
| Total interest income                                    | \$ 11,442 | \$ 10,843 | \$ 11,221 |
| Total interest expense                                   | 4,131     | 3,669     | 4,366     |
| Net interest income                                      | 7,311     | 7,174     | 6,855     |
| Provision for possible loan losses                       | 90        | 140       | 200       |
| Other operating income                                   | 1,713     | 1,530     | 1,508     |
| Other operating expenses                                 | 6,077     | 5,746     | 5,409     |
| Federal income taxes                                     | 631       | 601       | 591       |
| Net income   | \$ 2,226  | \$ 2,217  | \$ 2,163  |
| <b>PER SHARE DATA:</b>                                   |           |           |           |
| Earnings per share (1)                                   | \$ 1.76   | \$ 1.74   | \$ 1.69   |
| Cash dividends declared per share                        | .74       | 0.70      | 0.66      |
| Book value per share                                     | 23.06     | 22.49     | 21.63     |

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|  |            |            |            |
|--|------------|------------|------------|
| Average shares outstanding   | 1,262,171  | 1,274,034  | 1,281,265  |
| <br>BALANCE SHEET DATA:  |            |            |            |
| Total assets   | \$ 231,218 | \$ 235,377 | \$ 232,914 |
| Total loans  | 154,271    | 149,900    | 147,631    |
| Total securities   | 53,919     | 61,834     | 62,775     |
| Total deposits   | 164,847    | 172,487    | 171,786    |
| FHLB advances - long - term  | 11,311     | 11,323     | 11,335     |
| Total stockholders' equity   | 29,012     | 28,506     | 27,603     |
| <br>PERFORMANCE RATIOS:  |            |            |            |
| Return of average assets   | 0.97%      | 0.96%      | 0.94%      |
| Return on average stockholders' equity   | 7.73%      | 7.88%      | 7.95%      |
| Net interest margin (2)  | 3.63%      | 3.54%      | 3.39%      |
| Total non-interest expense as a percentage of average assets                   | 2.64%      | 2.45%      | 2.34%      |
| <br>ASSET QUALITY RATIOS:  |            |            |            |
| Allowance for possible loan losses as a percentage of loans, net               | 1.02%      | 0.93%      | 0.96%      |
| Allowance for possible loan losses as a percentage of non-performing loans (3) | 185.54%    | 110.37%    | 52.29%     |
| Non-performing loans as a percentage of total loans, net (3)                   | 0.55%      | 0.85%      | 1.85%      |
| Non-performing assets as a percentage of total assets (3)                      | 0.36%      | 0.54%      | 1.16%      |
| Net charge-offs as a percentage of average net loans (4)                       | (0.05%)    | 0.11%      | 0.06%      |
| <br>LIQUIDITY AND CAPITAL RATIOS:  |            |            |            |
| Equity to assets   | 12.55%     | 12.11%     | 11.85%     |
| Tier 1 capital to risk-weighted assets (5)                                     | 19.24%     | 19.27%     | 18.82%     |
| Leverage ratios (5) (6)  | 12.74%     | 12.17%     | 11.79%     |
| Total capital to risk-weighted assets (5)                                      | 20.32%     | 20.31%     | 19.88%     |
| Dividend payout ratio  | 41.92%     | 40.19%     | 39.02%     |

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- (1) Based upon average shares and common share equivalents outstanding.
- (2) Represents net interest income as a percentage of average total interest-earning assets, calculated on a tax-equivalent basis.
- (3) Non-performing loans are comprised of (i) loans which are on a non-accrual basis, (ii) accruing loans that are 90 days or more past due, and (iii) restructured loans. Non-performing assets are comprised of non-performing loans and foreclosed real estate (assets acquired in foreclosure), if applicable.
- (4) Based upon average balances for the respective periods.
- (5) Based on the Federal Reserve Bank's risk-based capital guidelines, as applicable to the Corporation. The Bank is subject to similar requirements imposed by the Comptroller of the Currency.
- (6) The leverage ratio is defined as the ratio of Tier 1 Capital to average total assets less intangible assets, if applicable.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the detailed information and financial statements, including notes thereto, included elsewhere in this Annual Report. Our consolidated financial condition

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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.

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### RESULTS OF OPERATIONS

Our net income increased by .41 percent from \$2,217,000 in 2004 to \$2,226,000 in 2005. Earnings per share increased by 1.15 percent from \$1.74 in 2004 to \$1.76 in 2005. Our return on average assets (ROAA) increased to 0.97 percent in 2005, compared to 0.96 percent in 2004. Our return on average equity (ROAE) decreased to 7.73 percent in 2005, compared to 7.88 percent in 2004.

Loans increased by 2.92 percent in 2005 to \$154,271,000 from \$149,900,000 in 2004. This increase was in the real estate area.

We instituted, in 1995, a dividend reinvestment plan and an employees stock purchase plan. Moreover, in 1999, we commenced a strategy to purchase and cancel up to 10 percent of our outstanding shares of common stock through open market purchases. In 2003, we again filed with the SEC to purchase up to 100,000 shares of our outstanding shares. These repurchase programs resulted in the purchase and cancellation of the following numbers of shares of our common stock for the years indicated: 18,000 shares (2005); 16,000 shares (2004); and 23,988 shares (2003). The net effect of the stock plans and the repurchase program resulted in weighted average shares of common stock outstanding as follows: 1,262,171 (2005); 1,274,034 (2004); and 1,281,265 (2003).

Tax-equivalent net interest income increased 1.32 percent to \$7.7 million in 2005 from \$7.6 million in 2004. Average earning assets were \$213.0 million in 2005 and \$215.1 million in 2004. Net interest income increased 1.39 percent from \$7.2 million in 2004 to \$7.3 million in 2005. This increase in net interest income is a result of the pricing and mix of our loans and deposits.

TABLE OF NON-INTEREST INCOME  
(Dollars in Thousands)

|                                   | Years Ended December 31, |         |         |
|-----------------------------------|--------------------------|---------|---------|
|                                   | 2005                     | 2004    | 2003    |
| Service charges and fees          | \$ 828                   | \$ 711  | \$ 572  |
| Gain on sale of loans             | 40                       | 36      | 190     |
| Bank-owned life insurance income  | 247                      | 257     | 247     |
| Trust department income           | 157                      | 165     | 148     |
| Investment securities gains - net | 34                       | 3       | 8       |
| Other                             | 407                      | 358     | 343     |
|                                   | -----                    | -----   | -----   |
| Total non-interest income         | \$1,713                  | \$1,530 | \$1,508 |
|                                   | =====                    | =====   | =====   |

Total non-interest income increased during 2005 from \$1,530,000 in 2004 to \$1,713,000 in 2005. The decrease in Trust income in the amount of \$8,000 was primarily due to accounts closed in 2005 and market valuations in 2005. Gain on sale of investment securities increased from \$3,000 in 2004 to \$34,000 in 2005. Service fees and charges increased from \$711,000 in 2004 to \$828,000 in 2005 or 16.46 percent. "Overdraft Privilege" was instrumental in this increase. Other

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income increased 13.69 percent from \$358,000 in 2004 to \$407,000 in 2005, partly attributable to fees collected for prepayment of loans. Gain on sale of loans increased from \$36,000 in 2004 to \$40,000 in 2005. Bank-owned life insurance income reflected a decrease of \$10,000 from \$257,000 in 2004 to \$247,000 in 2005.

TABLE OF OTHER NON-INTEREST EXPENSE  
(Dollars in Thousands)

|                                   | Years Ended December 31, |                |                |
|-----------------------------------|--------------------------|----------------|----------------|
|                                   | 2005                     | 2004           | 2003           |
| Salaries and wages                | \$2,324                  | \$2,289        | \$2,199        |
| Employee benefits                 | 791                      | 773            | 746            |
| Net occupancy expense             | 457                      | 394            | 379            |
| Furniture and equipment expense   | 518                      | 475            | 476            |
| State shares tax                  | 282                      | 274            | 275            |
| Professional services             | 226                      | 228            | 224            |
| Director's fees                   | 190                      | 147            | 141            |
| Stationery and supplies           | 130                      | 136            | 116            |
| Other expense                     | 1,160                    | 1,030          | 853            |
| <b>Total non-interest expense</b> | <b>\$6,078</b>           | <b>\$5,746</b> | <b>\$5,409</b> |

Total non-interest expense increased to \$6,078,000 in 2005 from \$5,746,000 in 2004 or an increase of 5.78 percent. A 1.73 percent increase in salaries and benefits was attributable to normal merit and cost of living increases as well as increased health insurance costs. Furniture and equipment expense increased from \$475,000 in 2004 to \$518,000 in 2005. Net occupancy expense increased \$63,000 from \$394,000 in 2004 to \$457,000 in 2005 or 15.99 percent. State shares tax increased \$8,000 for 2005 as compared to 2004. Other expenses increased 12.62 percent from \$1,030,000 in 2004 to \$1,160,000 in 2005. Components comprising some of the major changes were as follows:

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|  | Years Ended December 31, |         |                 |
|--|--------------------------|---------|-----------------|
|  | 2005                     | 2004    | % of<br>Inc/Dec |
| ATM Expense                            | 138,432                  | 119,675 | 15.67%          |
| Sarbanes-Oxley (SOX 404)               | 32,997                   | 0       | 100.00%         |
| Overdraft Privilege Program Consulting | 36,246                   | 24,178  | 49.91%          |
| Federal Reserve Cost                   | 62,046                   | 48,852  | 27.01%          |
| ATM Commission                         | 13,648                   | 1,466   | 830.97%         |
| Directors Fees                         | 171,800                  | 130,150 | 32.00%          |

The SOX 404 requirement has been delayed to December 31, 2007. We expect no

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SOX 404 expenses in 2006 other than employee time commitment. The Chairman of the Board received increased Directors Fees in lieu of salary beginning in 2005. The addition of a new ATM at our Buckhorn branch was responsible for the two ATM related expense increases. The move from DOS based Fedline to Internet based Fedline for wire transfer was primarily responsible for the increased Federal Reserve Costs. The Consulting for the Overdraft Privilege Program is complete; accordingly, there will be no consulting expense after 2005.

One standard to measure non-interest expense is to express non-interest expense as a percentage of average total assets. In 2005, this percentage was 2.64 percent compared to 2.45 percent in 2004.

Loan delinquencies increased 17.86 percent from \$1,753,000 in 2004 to \$2,066,000 in 2005. The increase in these delinquencies was attributed to 30 - 89 day past dues, mainly in the real estate area. Our management has been diligent in its efforts to reduce these delinquencies and has increased monitoring and review of current loans to foresee future delinquency occurrences and react to them quickly. The Bank has also implemented a centralized credit analysis department to better analyze new loan requests. The provision for loan losses for 2005 decreased from \$140,000 in 2004 to \$90,000 in 2005, although the allowance for loan losses as a percentage of loans increased to 1.02 percent from .93 percent.

### NET INTEREST INCOME

Tax-equivalent net interest income for 2005 equaled \$7,722,000 compared to \$7,605,000 in 2004, an increase of 1.54 percent. The increase in the overall net interest margin from 3.54 percent in 2004 to 3.63 percent in 2005 is a result of interest rate changes in the loan and deposit areas. These rates were diligently watched and adjusted which contributed to the overall increased performance of the Bank. Income received on interest bearing deposits with other financial institutions increased from an average of 1.10 percent for 2004 to an average of 3.13 percent for 2005. This 203 basis point increase reflects the increased short term rates by year-end 2005. The cost of long-term debt averaged 5.99 percent for the year which will continue to have a negative impact on our net interest margin until rates would rise enough to allow us to pay off this debt. We will continue to use the following strategies to mitigate this period of pressure on our net interest margin: pricing of deposits will continue to be monitored to meet current market conditions, large deposits over \$100,000 will continue to be priced conservatively; and in this low interest rate environment, the majority of new investments will be kept short term in anticipation of rising rates.

### TAX-EQUIVALENT NET INTEREST INCOME (Dollars in Thousands)

|  | Years Ended December 31, |          |          |
|--|--------------------------|----------|----------|
|  | 2005                     | 2004     | 2003     |
|  | -----                    | -----    | -----    |
| Interest income                                | \$11,442                 | \$10,843 | \$11,221 |
| Interest expense                               | 4,131                    | 3,669    | 4,366    |
|  | -----                    | -----    | -----    |
| Net interest income                            | 7,311                    | 7,174    | 6,855    |
|  | -----                    | -----    | -----    |
| Tax-equivalent adjustment                      | 411                      | 431      | 427      |
|  | -----                    | -----    | -----    |
| Net interest income (fully taxable equivalent) | \$ 7,722                 | \$ 7,605 | \$ 7,282 |
|  | =====                    | =====    | =====    |



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 years 2005, 2004 and 2003.

AVERAGE BALANCE SHEET AND RATE ANALYSIS  
THREE YEARS ENDED DECEMBER 31,  
(Dollars in thousands)

|  | 2005                      |                             |                    | 2004                        |                           |                    |
|--|---------------------------|-----------------------------|--------------------|-----------------------------|---------------------------|--------------------|
|  | Average<br>Balance<br>(1) | Interest<br>Inc./Exp<br>(2) | Average<br>Balance | Interest<br>Inc./Exp<br>(1) | Average<br>Yd/Rate<br>(2) | Average<br>Yd/Rate |
| <b>ASSETS:</b>   |                           |                             |                    |                             |                           |                    |
| Interest Bearing Deposits With Other<br>Financial Institutions | \$ 1,694                  | \$ 53                       | 3.13%              | \$ 4,652                    | \$ 51                     | 1.1%               |
| <b>Investment Securities:</b>                                  |                           |                             |                    |                             |                           |                    |
| Taxable  | 46,859                    | 1,588                       | 3.39%              | 52,428                      | 1,580                     | 3.0%               |
| State and Municipal Obligations (3)                            | 8,084                     | 363                         | 6.80%              | 9,571                       | 450                       | 7.0%               |
| Total Investment Securities                                    | \$ 54,943                 | \$ 1,951                    | 3.89%              | \$ 61,999                   | \$ 2,030                  | 3.3%               |
| Federal Funds Sold   | 5,809                     | 190                         | 3.27%              | 1,053                       | 16                        | 1.5%               |
| <b>Loans:</b>  |                           |                             |                    |                             |                           |                    |
| Taxable  | 140,388                   | 8,812                       | 6.28%              | \$139,086                   | 8,360                     | 6.0%               |
| Tax Free (3)   | 9,677                     | 436                         | 6.83%              | 8,262                       | 386                       | 7.0%               |
| Total Loans  | \$150,065                 | \$ 9,248                    | 6.31%              | \$147,348                   | \$ 8,746                  | 6.0%               |
| Total Interest-Earning Assets                                  | 212,511                   | 11,442                      | 5.58%              | \$215,052                   | \$10,843                  | 5.0%               |
| Reserve for Loan Losses  | (\$1,470)                 |                             |                    | (1,405)                     |                           |                    |
| Cash and Due from Banks  | 4,708                     |                             |                    | 4,912                       |                           |                    |
| Other Assets   | 14,332                    |                             |                    | 12,888                      |                           |                    |
| Total Assets   | \$230,081                 |                             |                    | \$231,447                   |                           |                    |
| <b>LIABILITIES AND CAPITAL:</b>                                |                           |                             |                    |                             |                           |                    |
| Total Interest-Bearing Deposits                                | \$150,289                 | 2,830                       | 1.88%              | \$154,840                   | \$ 2,684                  | 1.7%               |
| U.S. Treasury Short-Term Borrowings                            | 296                       | 9                           | 3.04%              | 296                         | 3                         | 1.0%               |
| Long-Term Borrowings   | 11,317                    | 678                         | 5.99%              | 11,343                      | 681                       | 6.0%               |
| Repurchase Agreements  | 20,640                    | 614                         | 2.97%              | 18,184                      | 301                       | 1.7%               |
| Total Interest-Bearing Liabilities                             | \$182,542                 | \$ 4,131                    | 2.26%              | \$184,663                   | \$ 3,669                  | 2.0%               |
| Demand Deposits  | \$ 17,523                 |                             |                    | 17,188                      |                           |                    |
| Other Liabilities  | 1,227                     |                             |                    | 1,460                       |                           |                    |
| Stockholders' Equity   | 28,789                    |                             |                    | 28,136                      |                           |                    |
| Total Liabilities and Capital                                  | \$230,081                 |                             |                    | \$231,447                   |                           |                    |

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|  | =====    |       | ===== |          | ===== |
|--|----------|-------|-------|----------|-------|
| NET INTEREST INCOME/NET INTEREST MARGIN (4)                | \$ 7,311 | 3.44% |       | \$ 7,174 | 3.44% |
| TAX-EQUIVALENT NET INTEREST INCOME/NET INTEREST MARGIN (5) | \$ 7,772 | 3.63% |       | \$ 7,605 | 3.63% |

- (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. Due to the availability of certain daily and monthly average balance information, certain reclassifications were made to prior period amounts.
- (2) Interest on loans includes fee income.
- (3) Yield on tax-exempt obligations has been computed on a tax-equivalent basis.
- (4) Net interest margin is computed by dividing net interest income by total interest-earning assets.
- (5) Interest and yield are presented on a tax-equivalent basis using 34 percent for 2005, 2004 & 2003.

COMPONENTS OF NET INTEREST INCOME

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 balance sheet as it pertains to net interest income, the table below reflects these changes for 2005 versus 2004, 2004 versus 2003, and 2003 versus 2002:

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TABLE OF NET INTEREST INCOME COMPONENTS ON A TAX-EQUIVALENT BASIS  
For the twelve months ended December 31, 2005  
(Dollars in thousands)

|  | 2005 Versus 2004                         |                 |       | 2004 Versus 2003                         |                 |       |
|--|--|-----------------|-------|--|-----------------|-------|
|  | Increase (Decrease)<br>Due to Changes In |                 |       | Increase (Decrease)<br>Due to Changes In |                 |       |
|  | Average<br>Volume                        | Average<br>Rate | Total | Average<br>Volume                        | Average<br>Rate | Total |
| Interest Income:   |  |                 |       |  |                 |       |
| Interest-Bearing Deposits with Other<br>Financial Institutions | \$ (33)                                  | \$ 94           | \$ 61 | \$ (2)                                   | \$ 5            | \$ 3  |
| Taxable Securities   | (168)                                    | 199             | 31    | 223                                      | 36              | 259   |
| State and Municipal Obligations                                | (106)                                    | (31)            | (137) | (242)                                    | 21              | (221) |
| Federal Funds Sold   | 72                                       | 18              | 90    | (95)                                     | (71)            | (166) |
| Taxable Loans  | 78                                       | 376             | 454   | (307)                                    | (331)           | (638) |
| Tax Free Loans   | 100                                      | (21)            | 79    | 300                                      | (25)            | 275   |

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|                                       |         |       |        |          |          |          |
|---------------------------------------|---------|-------|--------|----------|----------|----------|
| Total Earning Assets                  | (57)    | 635   | 578    | \$ (123) | \$ (365) | \$ (488) |
|                                       | -----   | ----- | -----  | -----    | -----    | -----    |
| Interest Expense:                     |         |       |        |          |          |          |
| Total Interest-Bearing Deposits       | (79)    | 232   | 153    | \$ (39)  | \$ (689) | \$ (728) |
| U.S. Treasury - Short-Term Borrowings | 0       | 6     | 6      | 0        | 1        | 1        |
| Long-Term Borrowings                  | (2)     | (1)   | (3)    | 0        | 1        | 1        |
| Repurchase Agreements                 | 41      | 238   | 279    | 24       | (5)      | 19       |
|                                       | -----   | ----- | -----  | -----    | -----    | -----    |
| Total Interest-Bearing Deposits       | \$ (40) | \$475 | \$ 435 | \$ (15)  | \$ (692) | \$ (707) |
|                                       | -----   | ----- | -----  | -----    | -----    | -----    |
| NET INTEREST INCOME                   | \$ (17) | \$160 | \$ 143 | \$ (108) | \$ 327   | \$ 219   |
|                                       | =====   | ===== | =====  | =====    | =====    | =====    |

### FINANCIAL CONDITION

Our consolidated assets at December 31, 2005 were \$231.2 million which represented a decrease of \$4.2 million or 1.78 percent over \$235.4 million at December 31, 2004. The comparable increase for 2004 over 2003 was 1.07 percent or \$2.5 million.

Capital increased 1.75 percent from \$28.5 million in 2004 to \$29.0 million in 2005. The net adjustment reflected in stockholders' equity for the fair market value of securities was a negative \$303,000 for 2005 compared to a positive \$213,000 for 2004. Common stock and surplus decreased a net \$270,000 resulting from purchase and retirement of stock in the amount of \$506,000 and stock issued under our stock plans in the amount of \$236,000.

Total average assets decreased .56 percent from 2004 at \$231.4 million to 2005 at \$230.1 million. Average earning assets were \$215.1 million in 2004 and \$212.5 million in 2005.

Loans increased 2.94 percent from \$149.9 million at December 31, 2004 to \$154.3 million at December 31, 2005.

Non-interest bearing deposits decreased 2.67 percent to \$18.2 million at December 31, 2005 from \$18.7 million at December 31, 2004. Interest bearing deposits decreased 4.68 percent from \$153.8 million in 2004 to \$146.6 million in 2005.

The loan-to-deposit ratio is a key measurement of liquidity. Our loan-to-deposit ratio increased during 2005 to 93.63 percent compared to 86.90 percent during 2004.

It is our opinion that the balance sheet mix and the interest rate risk associated with the balance sheet is within manageable parameters. Constant monitoring using asset/liability reports and interest rate risk scenarios are in place along with quarterly asset/liability management meetings on the committee level by the Bank's Board of Directors. Additionally, the Bank's Asset/Liability Committee meets quarterly with an investment consultant.

### INVESTMENTS (Dollars in thousands)

|   | 2005     | 2004     | 2003     |
|---|----------|----------|----------|
|   | -----    | -----    | -----    |
| Federal Agency Obligations                      | \$21,157 | \$18,135 | \$16,002 |
| Mortgage-backed Securities                      | 22,564   | 32,021   | 33,338   |
| Obligations of State and Political Subdivisions | 7,782    | 8,930    | 10,773   |

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|                              |          |          |          |
|------------------------------|----------|----------|----------|
| Marketable Equity Securities | 1,265    | 1,378    | 1,341    |
| Restricted Equity Securities | 1,151    | 1,370    | 1,321    |
|                              | -----    | -----    | -----    |
| Total Investment Securities  | \$53,919 | \$61,834 | \$62,775 |
|                              | =====    | =====    | =====    |

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All of our securities are available-for sale and are carried at estimated fair value. The following table sets forth the estimated maturity distribution of the investments, the weighted average yield for each type and ranges of maturity at December 31, 2005. Yields are presented on a tax-equivalent basis, are based upon carrying value and are weighted for the scheduled maturity. At December 31, 2005, our investment securities portfolio had an average maturity of approximately 3.79 years.

|  | (Dollars in Thousands) |       |   |       |  |       |                    |       |
|--|------------------------|-------|---|-------|--|-------|--------------------|-------|
|  | Within<br>One Year     |       | After One<br>Year But<br>Within<br>Five Years |       | After Five<br>Years But<br>Within<br>Ten Years |       | After<br>Ten Years |       |
|  | Amount                 | Yield | Amount  | Yield | Amount   | Yield | Amount             | Yield |
|  | -----                  | ----- | -----   | ----- | -----  | ----- | -----              | ----- |
| Federal Agency Obligations                         | \$3,781                | 2.64% | \$36,702                                      | 3.77% | \$3,237  | 7.72% | \$ 0               | 0.00% |
| Obligations of State and<br>Political Subdivisions | 0                      | 0.00% | 0   | 0.00% | 4,791  | 7.11% | 2,992              | 6.04% |
| Marketable Equity Securities                       | 0                      | 0.00% | 0   | 0.00% | 0  | 0.00% | 1,265              | 3.15% |
| Restricted Equity Securities                       | 0                      | 0.00% | 0   | 0.00% | 0  | 0.00% | 1,151              | 3.38% |
|  | -----                  | ----- | -----   | ----- | -----  | ----- | -----              | ----- |
| Total  | \$3,781                | 2.64% | \$36,702                                      | 3.77% | \$8,028  | 7.65% | \$5,408            | 4.91% |
|  | =====                  | ----- | =====   | ----- | =====  | ----- | =====              | ----- |

Available-for-sale securities are reported on the balance sheet at fair value. An adjustment to capital, net of deferred taxes, is the offset for this entry. The possibility of material price volatility in a changing interest rate environment is offset by the availability to us of restructuring the portfolio for gap positioning at any time through the securities classed as available-for-sale. The impact of the fair value accounting was an unrealized loss, net of tax, on December 31, 2005 of \$303,000 compared to an unrealized gain, net of tax, on December 31, 2004 of \$213,000.

The mix of securities in the portfolio at December 31, 2005 was 81.1 percent Federal Agency Obligations, 14.4 percent Municipal Securities, and 4.5 percent Other. We do not engage in derivative investment products.

LOANS

LOAN PORTFOLIO  
LOANS OUTSTANDING  
(Dollars in thousands)

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|                                     | 2005      | 2004      | 2003      | 2002      | 2001      |
|-------------------------------------|-----------|-----------|-----------|-----------|-----------|
|                                     | -----     | -----     | -----     | -----     | -----     |
| Commercial                          | \$ 12,097 | \$ 12,182 | \$ 15,328 | \$ 15,033 | \$ 13,091 |
| Tax-Exempt                          | 9,019     | 10,062    | 6,214     | 3,535     | 1,947     |
| Real Estate - Construction          | 1,548     | 734       | 2,505     | 1,185     | 2,538     |
| Real Estate                         | 127,170   | 122,104   | 118,129   | 123,746   | 115,716   |
| Personal                            | 4,348     | 4,738     | 5,410     | 7,902     | 9,962     |
|                                     | -----     | -----     | -----     | -----     | -----     |
| Total Gross Loans                   | \$154,182 | \$149,820 | \$147,586 | \$151,401 | \$143,254 |
| Add (Deduct) Unearned discount      | (30)      | (46)      | (64)      | (139)     | (279)     |
| Unamortized loan costs, net of fees | 119       | 126       | 109       | 76        | 15        |
|                                     | -----     | -----     | -----     | -----     | -----     |
| Loans, Net                          | \$154,271 | \$149,900 | \$147,631 | \$151,338 | \$142,990 |
|                                     | =====     | =====     | =====     | =====     | =====     |

The loan portfolio increased 2.94 percent from \$149.9 million in 2004 to \$154.3 million in 2005. The percentage distribution in the loan portfolio was 83.48 percent in real estate loans at \$128.8 million; 7.85 percent in commercial loans at \$12.1 million; 2.82 percent in consumer loans at \$4.3 million; and 5.85 percent in tax exempt loans at \$9.0 million. Real estate loans were comprised of 6.35 percent with 7/3-year adjustable rates, .09 percent with 5/3-year adjustable rates, 5.78 percent with 5-year adjustable rates; 45.26 percent with 3-year adjustable rates; 11.99 percent with 1-year adjustable rates; and 8.08 percent with one-day to 3-month adjustable rates. Many adjustable rate loans have bi-weekly payments. The remaining 22.45 percent of real estate loans were fixed rates.

The following table presents the percentage distribution of loans by category as of the date indicated:

|                          | For the years ended December 31, |          |          |          |          |
|--------------------------|----------------------------------|----------|----------|----------|----------|
|                          | 2005 (%)                         | 2004 (%) | 2003 (%) | 2002 (%) | 2001 (%) |
|                          | -----                            | -----    | -----    | -----    | -----    |
| Commercial               | 7.85                             | 8.13     | 10.38    | 9.93     | 9.14     |
| Tax Exempt               | 5.85                             | 6.71     | 4.21     | 2.34     | 1.36     |
| Real Estate-Construction | 1.00                             | .49      | 1.70     | 0.78     | 1.77     |
| Real Estate              | 82.48                            | 81.54    | 80.04    | 81.73    | 80.78    |
| Personal                 | 2.82                             | 3.13     | 3.67     | 5.22     | 6.95     |
|                          | -----                            | -----    | -----    | -----    | -----    |
| Total Loans              | 100.00                           | 100.00   | 100.00   | 100.00   | 100.00   |
|                          | =====                            | =====    | =====    | =====    | =====    |

The following table shows the maturity or repricing of loans in specified categories of the Bank's loan portfolio at December 31, 2005, and the amount of such loans with predetermined fixed rates or with floating or adjustable rates. Expected payments are included in the table.

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| Dollars in Thousands                                      | December 31, 2005         |                                   |                                    |                       |           |
|---|---------------------------|-----------------------------------|------------------------------------|-----------------------|-----------|
|   | In One<br>Year<br>Or Less | One Year<br>Through<br>Five Years | Five Years<br>Through<br>Ten Years | After<br>Ten<br>Years | Total     |
| Commercial, Tax Exempt, Real Estate and<br>Personal Loans | \$59,031                  | \$62,482                          | \$17,615                           | \$13,595              | \$152,723 |
| Real Estate-Construction Loans                            | 1,548                     | 0                                 | 0                                  | 0                     | 1,548     |
| Total   | \$60,579                  | \$62,482                          | \$17,615                           | \$13,595              | \$154,271 |
| Amount of Such Loans with:                                |                           |                                   |                                    |                       |           |
| Predetermined Fixed Rates                                 | \$ 7,836                  | \$ 7,230                          | \$15,097                           | \$13,595              | \$ 43,758 |
| Floating or Adjustable Rates                              | 52,743                    | 55,252                            | 2,518                              | 0                     | 110,513   |
| Total   | \$60,579                  | \$62,482                          | \$17,615                           | \$13,595              | \$154,271 |

DEPOSITS AND BORROWED FUNDS

TABLE OF DISTRIBUTION OF AVERAGE DEPOSITS  
(Dollars in thousands)

|                                   | December 31, |           |           |
|-----------------------------------|--------------|-----------|-----------|
|                                   | 2005         | 2004      | 2003      |
| Demand deposits                   | \$ 46,307    | \$ 46,953 | \$ 43,106 |
| Savings deposits                  | 37,539       | 37,881    | 37,146    |
| Time deposits                     | 58,380       | 60,003    | 61,588    |
| Time deposits, \$100,000 and over | 25,586       | 27,191    | 30,782    |
| Total                             | \$167,812    | \$172,028 | \$172,622 |

TABLE OF MATURITY DISTRIBUTION OF TIME DEPOSITS OVER \$100,000  
(Dollars in thousands)

|                                  | December 31, |          |          |
|----------------------------------|--------------|----------|----------|
|                                  | 2005         | 2004     | 2003     |
| Three months or less             | \$ 5,803     | \$ 6,695 | \$ 7,571 |
| Over three months to six months  | 1,267        | 3,034    | 2,099    |
| Over six months to twelve months | 5,736        | 6,879    | 6,990    |
| Over twelve months               | 12,822       | 9,722    | 11,272   |
| Total                            | \$25,628     | \$26,330 | \$27,932 |

Total average deposits decreased by 2.4 percent from \$172.0 million at

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year-end 2004 to \$167.8 million at year-end 2005. Average savings deposits decreased to \$37.5 million at year-end 2005 from \$37.9 million at year-end 2004. Average time deposits decreased 3.67 percent from \$87.2 million at year-end 2004 to \$84.0 million at year-end 2005. Average non-interest bearing demand deposits increased to \$17.5 million for 2005 from \$17.2 million for 2004. Average interest bearing NOW accounts decreased 3.36 percent from \$29.8 million for 2004 to \$28.8 million for 2005. This change in deposit mix resulted in an overall positive impact to earnings, due to the decrease in Certificates of deposit over \$100,000 and all other interest-bearing deposits.

Short-term borrowings, securities sold under agreements to repurchase and day-to-day borrowings from the FHLB increased 12.84 percent from \$21.8 million at year-end 2004 to \$24.6 million at year-end 2005. Treasury Tax and Loan deposits held by us for the U.S. Treasury averaged \$296,000 for 2005. One-day borrowings did not occur in 2005 and repurchase agreements increased from an average \$18.2 million in 2004 to \$20.6 million in 2005. Long-term borrowings, namely borrowings from the FHLB-Pgh, averaged \$11.3 million for 2005.

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### NON-PERFORMING ASSETS PAST DUE AND NON-ACCRUAL LOANS (Dollars in thousands)

| 2005         | Real<br>Estate | Installment<br>Loans | Commercial | Total   |
|--------------|----------------|----------------------|------------|---------|
| ----         | -----          | -----                | -----      | -----   |
| Days 30-89   | \$1,152        | \$65                 | \$ 12      | \$1,229 |
| Days 90 Plus | 128            | 2                    | 0          | 130     |
| Non-accrual  | 518            | 0                    | 189        | 707     |
|              | -----          | ---                  | ----       | -----   |
| Total        | \$1,798        | \$67                 | \$201      | \$2,066 |
|              | =====          | ===                  | ====       | =====   |

| 2004         | Real<br>Estate | Installment<br>Loans | Commercial | Total  |
|--------------|----------------|----------------------|------------|--------|
| ----         | -----          | -----                | -----      | -----  |
| Days 30-89   | \$ 421         | \$71                 | \$ 0       | \$ 492 |
| Days 90 Plus | 20             | 0                    | 0          | 20     |
| Non-accrual  | 902            | 0                    | 339        | 1,241  |
|              | -----          | ---                  | ----       | -----  |
| Total        | \$1,343        | \$71                 | \$339      | 1,753  |
|              | =====          | ===                  | ====       | =====  |

| 2003       | Real<br>Estate | Installment<br>Loans | Commercial | Total  |
|------------|----------------|----------------------|------------|--------|
| ----       | -----          | -----                | -----      | -----  |
| Days 30-89 | \$ 438         | \$66                 | \$ 81      | \$ 585 |

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|              |         |      |       |         |
|--------------|---------|------|-------|---------|
| Days 90 Plus | 345     | 0    | 24    | 369     |
| Non-accrual  | 1,208   | 3    | 641   | 1,852   |
|              | -----   | ---  | ----  | -----   |
| Total        | \$1,991 | \$69 | \$746 | \$2,806 |
|              | =====   | ===  | ===== | =====   |

At year-end 2005, loans 30-89 days past due totaled \$1,229,000 compared to \$492,000 at year-end 2004. Past due loans 90 days plus totaled \$130,000 at year-end 2005 compared to \$20,000 at year-end 2004. Non-accrual loans at year-end 2005 totaled \$707,000 compared to \$1,241,000 at year-end 2004. Overall, past due and non-accrual loans increased 17.9 percent from \$1,753,000 at year-end 2004 to \$2,066,000 at year-end 2005. During this same period of time, the ratio of net charge offs during the period to average loans outstanding during the period was (.05) percent. (See Summary of Loan Loss Experience). We do not consider these percentages to be significant or material.

Refer to the Loan section of footnote one to the Consolidated Financial Statements, Item 8.

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The following table presents a summary of the Bank's loan loss experience as of the dates indicated:

|   | For Years Ended December 31, |           |           |           |          |
|---|------------------------------|-----------|-----------|-----------|----------|
|   | 2005                         | 2004      | 2003      | 2002      | 2001     |
|   | -----                        | -----     | -----     | -----     | -----    |
| Loans Outstanding at End of Period          | \$154,271                    | \$149,900 | \$147,631 | \$151,338 | \$142,99 |
|   | =====                        | =====     | =====     | =====     | =====    |
| Average Loans Outstanding during the Period | \$150,065                    | \$147,348 | \$148,344 | \$147,545 | \$139,21 |
|   | =====                        | =====     | =====     | =====     | =====    |
| Balance of Loan Losses:                     |                              |           |           |           |          |
| Balance, Beginning of Period                | \$ 1,392                     | \$ 1,415  | \$ 1,298  | \$ 1,028  | \$ 1,00  |
|   | -----                        | -----     | -----     | -----     | -----    |
| Loans Charged Off:                          |                              |           |           |           |          |
| Commercial and Industrial                   | 0                            | (147)     | (52)      | (29)      | (9       |
| Real Estate Mortgages                       | 0                            | (25)      | 0         | (17)      | (1       |
| Consumer                                    | (54)                         | (31)      | (76)      | (54)      | (8       |
|   | -----                        | -----     | -----     | -----     | -----    |
| Total Loans Charged Off                     | (54)                         | (203)     | (128)     | (100)     | (18      |
| Recoveries:                                 |                              |           |           |           |          |
| Commercial and Industrial                   | 79                           | 0         | 12        | 19        | 1        |
| Real Estate Mortgages                       | 0                            | 5         | 0         | 0         |          |
| Credit Cards                                | 0                            | 0         | 0         | 0         |          |
| Consumer                                    | 46                           | 35        | 33        | 42        | 2        |
|   | -----                        | -----     | -----     | -----     | -----    |
| Total Recoveries                            | 125                          | 40        | 45        | 61        | 4        |
|   | -----                        | -----     | -----     | -----     | -----    |
| Net Loans Charged Off                       | 71                           | (163)     | (83)      | (39)      | (14      |
|   | -----                        | -----     | -----     | -----     | -----    |
| Provision for Loan Losses                   | 90                           | 140       | 200       | 309       | 16       |
|   | -----                        | -----     | -----     | -----     | -----    |
| Balance, End of Period                      | \$ 1,553                     | \$ 1,392  | \$ 1,415  | \$ 1,298  | \$ 1,02  |
|   | =====                        | =====     | =====     | =====     | =====    |



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|  |        |       |       |       |       |
|--|--------|-------|-------|-------|-------|
| Ratio of net charge-offs during the year to<br>average loans outstanding during year | (.05%) | 0.11% | 0.06% | 0.03% | 0.1   |
|  | =====  | ===== | ===== | ===== | ===== |

The following table presents an allocation of the Bank's allowance for loan losses for specific categories as of the dates indicated:

| Dollars in Thousands  | For Years Ended December 31, |         |         |         |         |
|-----------------------|------------------------------|---------|---------|---------|---------|
|                       | 2005                         | 2004    | 2003    | 2002    | 2001    |
| Commercial            | \$ 208                       | \$ 349  | \$ 493  | \$ 406  | \$ 372  |
| Real Estate Mortgages | 694                          | 755     | 696     | 723     | 464     |
| Consumer              | 32                           | 24      | 28      | 66      | 94      |
| Unallocated           | 619                          | 264     | 198     | 103     | 98      |
| Total                 | \$1,553                      | \$1,392 | \$1,415 | \$1,298 | \$1,028 |
|                       | =====                        | =====   | =====   | =====   | =====   |

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The following table presents a summary of the Bank's nonaccrual, restructured and past due loans as of the dates indicated:

| Dollars in thousands   | For Years Ended December 31, |           |           |           |          |
|--|------------------------------|-----------|-----------|-----------|----------|
|  | 2005                         | 2004      | 2003      | 2002      | 2001     |
| Nonaccrual, Restructured and Past Due Loans:                       |                              |           |           |           |          |
| Nonaccrual Loans   | \$ 707                       | \$ 1,241  | \$ 1,336  | \$ 2,112  | \$ 729   |
| Restructured Loans on Accrual Status                               | 0                            | 0         | 516       | 0         | 0        |
| Accrual Loans Past Due 90 Days or More                             | 130                          | 20        | 369       | 50        | 969      |
| Total Nonaccrual, Restructured and Past Due Loans                  | \$ 837                       | \$ 1,261  | \$ 2,221  | \$ 2,162  | \$ 1,698 |
|  | =====                        | =====     | =====     | =====     | =====    |
| Other Real Estate  | \$ 0                         | \$ 0      | \$ 36     | \$ 68     | \$ 0     |
| Interest Income That Would Have Been Recorded Under Original Terms | \$87,105                     | \$129,182 | \$142,873 | \$131,335 | \$37,712 |
| Interest Income Recorded During the Period                         | \$28,215                     | \$ 86,834 | \$ 17,586 | \$ 67,873 | \$61,568 |

ALLOWANCE FOR LOAN LOSSES AND RELATED PROVISION  
(Dollars in Thousands)

| Outstanding Balance at December 31, |       |       |
|-------------------------------------|-------|-------|
| 2005                                | 2004  | 2003  |
| -----                               | ----- | ----- |

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|                       | Amount  | % of Loans<br>in Category<br>to Total Loans | Amount  | % of Loans<br>in Category<br>to Total Loans | Amount  | % of Loans<br>in Category<br>to Total Loans |
|-----------------------|---------|---|---------|---|---------|---|
|                       | -----   | -----                                       | -----   | -----                                       | -----   | -----                                       |
| Commercial            | \$ 208  | 13.7%                                       | \$ 349  | 15.6%                                       | \$ 493  | 13.1%                                       |
| Real estate mortgages | 694     | 83.5%                                       | 755     | 81.3%                                       | 696     | 81.7%                                       |
| Consumer              | 32      | 2.8%  | 24      | 3.1%  | 28      | 5.2%  |
| Unallocated           | 619     | N/A   | 264     | N/A   | 198     | N/A   |
|                       | -----   | -----                                       | -----   | -----                                       | -----   | -----                                       |
|                       | \$1,553 | 100.0%                                      | \$1,392 | 100.0%                                      | \$1,415 | 100.0%                                      |
|                       | =====   | =====                                       | =====   | =====                                       | =====   | =====                                       |

The allowance for loan losses was \$1,553,000 at December 31, 2005, compared to \$1,392,000 at December 31, 2004. This allowance equaled 1.02 percent and .93 percent of total loans, net of unearned income, at the end of 2005 and 2004, respectively. Allowance was considered adequate based on delinquency trends and actual loans written as it relates to the loan portfolio.

The loan loss reserve was analyzed quarterly and reviewed by the Bank's Board of Directors. The assessment of the loan policies and procedures during 2005 revealed no anticipated loss on any loans considered "significant". No concentration or apparent deterioration in classes of loans or pledged collateral was evident, although slight concentrations existed in one to four family residential loans and in municipal loans. Monthly loan meetings with the Bank's Credit Administration Committee reviewed new loans, delinquent loans and loan exceptions to determine compliance with policies.

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### 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, sales of assets, growth in 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 "Factors That May Affect Future Results" and refer to consolidated Statements of Cash Flows.

### CAPITAL RESOURCES

Capital continues to be a strength for us. 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 December 31, 2005, the most recent notification from the Comptroller of the Currency, the Bank's primary federal regulator, categorized the Bank 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 as set forth in the Table. There are no conditions or events since that notification that management

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believes have changed the institution's category.

The Bank's actual capital amounts are ratios in the following table:

|                           | Actual   |          | For Capital Adequacy Purposes |          | To be Well Capitalized Under Prompt Corrective Action Provisions |          |
|---------------------------|----------|----------|-------------------------------|----------|--|----------|
|                           | Amount   | Ratio(%) | Amount                        | Ratio(%) | Amount   | Ratio(%) |
| As of December 31, 2005:  |          |          |                               |          |  |          |
| Total Risk Based Capital  |          |          |                               |          |  |          |
| (To risk-weighted assets) | \$30,950 | 20.32%   | \$12,185                      | 8.00%    | \$15,231   | 10.00%   |
| Tier I Capital            |          |          |                               |          |  |          |
| (To risk-weighted assets) | \$29,315 | 19.24%   | \$ 6,095                      | 4.00%    | \$ 9,142   | 6.00%    |
| Tier I Capital            |          |          |                               |          |  |          |
| (To average assets)       | \$37,347 | 12.74%   | \$11,726                      | 4.00%    | \$14,657   | 5.00%    |
| As of December 31, 2004:  |          |          |                               |          |  |          |
| Total Risk Based Capital  |          |          |                               |          |  |          |
| (To risk-weighted assets) | \$30,027 | 20.31%   | \$11,827                      | 8.00%    | \$14,784   | 10.00%   |
| Tier I Capital            |          |          |                               |          |  |          |
| (To risk-weighted assets) | \$28,488 | 19.27%   | \$ 5,913                      | 4.00%    | \$ 8,870   | 6.00%    |
| Tier I Capital            |          |          |                               |          |  |          |
| (To average assets)       | \$34,669 | 12.17%   | \$11,394                      | 4.00%    | \$14,244   | 5.00%    |

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

Dividend payouts are restricted by the Pennsylvania Business Corporation Law of 1988, as amended (the BCL). The BCL operates generally to preclude dividend payments if the effect thereof would render us unable to meet our obligations as they become due. As a practical matter, our payment of dividends is contingent upon our ability to obtain funding in the form of dividends from the Bank. Payment of dividends to us by the Bank is subject to the restrictions set forth in the National Bank Act. Generally, the National Bank Act would permit the Bank to declare dividends in 2006 to the Corporation of approximately \$2,274,585 plus additional amounts equal to the net income earned in 2006 for the period January 1, 2006 through the date of declaration, less any dividends which may be paid in 2006.

### 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

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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 the net interest spread.

STATEMENT OF INTEREST SENSITIVITY GAP  
(Dollars in thousands)  
December 31, 2005

|                                      | 90 Days<br>Or Less | > 90 Days<br>But<br><1 Year | 1 to 5<br>Years  | 5 to 10<br>Years | > 10<br>Years   | To        |
|--------------------------------------|--------------------|-----------------------------|------------------|------------------|-----------------|-----------|
| Short-term investments               | \$ 6,239           | \$ 0                        | \$ 0             | \$ 0             | \$ 0            | \$        |
| Securities Available-for-Sale (1)    | 2,916              | 21,656                      | 25,341           | 1,190            | 2,816           | 5         |
| Loans (1)                            | 29,051             | 35,549                      | 82,356           | 5,030            | 2,285           | 15        |
| <b>Rate Sensitive Assets</b>         | <b>38,206</b>      | <b>57,205</b>               | <b>107,697</b>   | <b>6,220</b>     | <b>5,101</b>    | <b>21</b> |
| Deposits:                            |                    |                             |                  |                  |                 |           |
| Interest-bearing demand deposits (2) | \$ 3,752           | \$ 3,463                    | \$ 21,644        | \$ 0             | \$ 0            | \$ 2      |
| Savings (2)                          | 4,520              | 4,172                       | 26,076           | 0                | 0               | 3         |
| Time                                 | 26,032             | 31,609                      | 25,330           | 0                | 0               | 8         |
| Borrowed funds                       | 22,991             | 0                           | 1,609            | 0                | 0               | 2         |
| Long-term debt                       | 3                  | 9                           | 11,183           | 38               | 78              | 1         |
| Shareholder's Equity                 | 0                  | 0                           | 0                | 0                | 29,012          | 2         |
| <b>Rate Sensitive Liabilities</b>    | <b>57,298</b>      | <b>39,253</b>               | <b>85,842</b>    | <b>38</b>        | <b>29,090</b>   | <b>21</b> |
| <b>Interest Sensitivity Gap</b>      | <b>(19,092)</b>    | <b>17,952</b>               | <b>21,855</b>    | <b>6,182</b>     | <b>(23,989)</b> |           |
| <b>Cumulative Gap</b>                | <b>\$(19,672)</b>  | <b>\$(1,140)</b>            | <b>\$ 20,715</b> | <b>\$26,897</b>  | <b>\$ 2,908</b> | <b>\$</b> |

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- (1) Investments and loans are included at the earlier of repricing or maturity and adjusted for the effects of prepayments.
- (2) Interest bearing demand and savings accounts are included based on historical experience and managements' judgment about the behavior of these deposits in changing interest rate environments.

At December 31, 2005 our cumulative gap positions and the potential earnings change resulting from a 200 basis point change in rates were within the internal risk management guidelines.

Upon reviewing the current interest sensitivity scenario at the one year interval, interest rates should not affect net income because the Bank's maturing and repricing assets and liabilities are near equally matched. At the one to five year interval an increasing interest rate environment would positively affect net income because more assets than liabilities will reprice.

Certain shortcomings are inherent in the method of analysis presented in the above table. Although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable-rate mortgages, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayment and early withdrawal levels may deviate significantly from those assumed in calculating the table. The ability of many borrowers to service their adjustable-rate debt may decrease in the event of an interest rate increase.

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In addition to gap analysis, the Bank uses earnings simulation to assist in measuring and controlling interest rate risk.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information called for by this item can be found at Item 7 of this Annual Report under the caption "Interest Rate Risk Management" and is incorporated in its entirety by reference under this Item 7A.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CCFNB BANCORP, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2005 AND 2004

2005

2004

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|   |               |            |
|---|---------------|------------|
| ASSETS  |               |            |
| Cash and due from banks   | \$ 5,122,797  | \$ 5,017,  |
| Interest-bearing deposits with other banks  | 1,110,241     | 1,820,     |
| Federal funds sold  | 5,128,786     | 5,994,     |
| Investment securities available-for-sale  | 53,919,318    | 61,834,    |
| Loans, net of unearned income   | 154,271,362   | 149,899,   |
| Allowance for loan losses   | 1,552,576     | 1,391,     |
|   | -----         | -----      |
| Net loans   | 152,718,786   | 148,507,   |
| Premises and equipment, net   | 4,836,739     | 4,518,     |
| Cash surrender value of bank-owned life insurance   | 6,480,223     | 6,199,     |
| Accrued interest receivable   | 959,339       | 816,       |
| Other assets  | 941,425       | 668,       |
|   | -----         | -----      |
| TOTAL ASSETS  | \$231,217,654 | \$235,376, |
|   | =====         | =====      |
| LIABILITIES AND STOCKHOLDERS' EQUITY LIABILITIES  |               |            |
| Deposits:   |               |            |
| Non-interest bearing  | \$ 18,249,315 | \$ 18,687, |
| Interest bearing  | 146,597,543   | 153,799,   |
|   | -----         | -----      |
| Total Deposits  | 164,846,858   | 172,487,   |
| Short-term borrowings   | 24,599,711    | 21,757,    |
| Long-term borrowings  | 11,310,669    | 11,323,    |
| Accrued interest and other expenses   | 1,441,966     | 1,268,     |
| Other liabilities   | 6,024         | 33,        |
|   | -----         | -----      |
| TOTAL LIABILITIES   | 202,205,228   | 206,870,   |
|   | =====         | =====      |
| STOCKHOLDERS' EQUITY  |               |            |
| Common stock, par value \$1.25 per share; authorized 5,000,000 shares;<br>issued and outstanding 1,258,337 shares 2005, 1,267,718 shares 2004 | 1,572,921     | 1,584,     |
| Surplus   | 3,126,502     | 3,384,     |
| Retained earnings   | 24,616,500    | 23,323,    |
| Accumulated other comprehensive income (loss)   | (303,497)     | 213,       |
|   | -----         | -----      |
| TOTAL STOCKHOLDERS' EQUITY  | 29,012,426    | 28,506,    |
|   | =====         | =====      |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY  | \$231,217,654 | \$235,376, |
|   | =====         | =====      |

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

CCFNB BANCORP, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF INCOME  
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

|  | 2005         | 2004         | 2003       |
|--|--------------|--------------|------------|
|  | -----        | -----        | -----      |
| INTEREST INCOME                                  |              |              |            |
| Interest and fees on loans                       | \$ 9,249,147 | \$ 8,746,190 | \$ 9,206,8 |
| Interest and dividends on investment securities: |              |              |            |

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|   |              |              |            |
|---|--------------|--------------|------------|
| Taxable   | 1,505,644    | 1,508,096    | 1,252,9    |
| Tax-exempt  | 362,543      | 449,988      | 609,4      |
| Dividends   | 81,812       | 71,944       | 60,9       |
| Federal funds sold                                  | 189,773      | 15,662       | 42,5       |
| Deposits in other banks                             | 52,766       | 51,279       | 48,4       |
|   | -----        | -----        | -----      |
| TOTAL INTEREST INCOME                               | 11,441,685   | 10,843,159   | 11,221,3   |
|   | -----        | -----        | -----      |
| INTEREST EXPENSE                                    |              |              |            |
| Deposits  | 2,829,972    | 2,684,235    | 3,400,4    |
| Short-term borrowings                               | 623,321      | 303,883      | 286,2      |
| Long-term borrowings                                | 677,835      | 680,816      | 679,2      |
|   | -----        | -----        | -----      |
| TOTAL INTEREST EXPENSE                              | 4,131,128    | 3,668,934    | 4,365,9    |
|   | -----        | -----        | -----      |
| Net interest income                                 | 7,310,557    | 7,174,225    | 6,855,3    |
| Provision for loan losses                           | 90,000       | 140,000      | 200,0      |
|   | -----        | -----        | -----      |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 7,220,557    | 7,034,225    | 6,655,3    |
|   | -----        | -----        | -----      |
| NON-INTEREST INCOME                                 |              |              |            |
| Service charges and fees                            | 828,430      | 710,866      | 572,1      |
| Gain on sale of loans                               | 40,046       | 35,959       | 190,3      |
| Bank-owned life insurance income                    | 247,036      | 257,246      | 247,3      |
| Trust department                                    | 156,753      | 165,017      | 147,4      |
| Investment securities gains, net                    | 33,947       | 3,537        | 8,3        |
| Other   | 407,128      | 357,673      | 342,1      |
|   | -----        | -----        | -----      |
| TOTAL NON-INTEREST INCOME                           | 1,713,340    | 1,530,298    | 1,507,8    |
|   | -----        | -----        | -----      |
| NON-INTEREST EXPENSE                                |              |              |            |
| Salaries  | 2,323,825    | 2,288,564    | 2,199,1    |
| Pensions and other employee benefits                | 790,878      | 772,833      | 746,3      |
| Occupancy, net                                      | 456,713      | 394,134      | 378,8      |
| Equipment   | 518,498      | 474,879      | 476,2      |
| State shares tax                                    | 281,581      | 273,861      | 275,0      |
| Professional services                               | 225,905      | 228,302      | 223,6      |
| Directors' fees                                     | 189,833      | 147,152      | 140,5      |
| Stationery and supplies                             | 130,018      | 136,232      | 116,3      |
| Other   | 1,160,576    | 1,030,042    | 853,0      |
|   | -----        | -----        | -----      |
| TOTAL NON-INTEREST EXPENSE                          | 6,077,827    | 5,745,999    | 5,409,2    |
|   | -----        | -----        | -----      |
| Income before income taxes                          | 2,856,070    | 2,818,524    | 2,754,0    |
| Income tax expense                                  | 630,512      | 601,111      | 591,1      |
|   | -----        | -----        | -----      |
| NET INCOME  | \$ 2,225,558 | \$ 2,217,413 | \$ 2,162,8 |
|   | -----        | -----        | -----      |
| PER SHARE DATA                                      |              |              |            |
| Net income  | \$ 1.76      | \$ 1.74      | \$ 1.      |
| Cash dividends                                      | 0.74         | 0.70         | 0.         |
| Weighted average shares outstanding                 | 1,262,171    | 1,274,034    | 1,281,2    |

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

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CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

|  | Common<br>Stock | Surplus     | Comprehensive<br>Income | Retained<br>Earnings | Comp<br>Inco |
|--|-----------------|-------------|-------------------------|----------------------|--------------|
|  | -----           | -----       | -----                   | -----                | -----        |
| BALANCE AT DECEMBER 31, 2002   | \$1,615,905     | \$4,008,665 |                         | \$20,678,631         | \$           |
| Comprehensive income:  |                 |             |                         |                      |              |
| Net income   | --              | --          | \$2,162,897             | 2,162,897            |              |
| Change in net unrealized gain on<br>investment securities available<br>-for-sale, net of<br>reclassification adjustment and<br>tax effects | --              | --          | (161,103)               | --                   | (            |
| Total comprehensive income   |                 |             | \$2,001,794             |                      |              |
| Issuance of 7,709 shares of common<br>stock under dividend reinvestment<br>and stock purchase plans  | 9,636           | 184,159     |                         | --                   |              |
| Purchase of 23,988 shares of treasury<br>stock   | --              | --          |                         | --                   |              |
| Retirement of 23,988 shares of<br>treasury stock   | (29,985)        | (558,216)   |                         | --                   |              |
| Cash dividends \$.66 per share   | --              | --          |                         | (843,989)            |              |
| BALANCE AT DECEMBER 31, 2003   | 1,595,556       | 3,634,608   |                         | 21,997,539           |              |
| Comprehensive income:  |                 |             |                         |                      |              |
| Net income   | --              | --          | \$2,217,413             | 2,217,413            |              |
| Change in net unrealized gain on<br>investment securities available<br>-for-sale, net of<br>reclassification adjustment and<br>tax effects | --              | --          | (162,562)               | --                   | (            |
| Total comprehensive income   |                 |             | \$2,054,851             |                      |              |
| Issuance of 7,273 shares of common<br>stock under dividend reinvestment<br>and stock purchase plans  | 9,092           | 197,153     |                         | --                   |              |
| Purchase of 16,000 shares of treasury<br>stock   | --              | --          |                         | --                   |              |
| Retirement of 16,000 shares of<br>treasury stock   | (20,000)        | (447,000)   |                         | --                   |              |
| Cash dividends \$.70 per share   | --              | --          |                         | (890,997)            |              |
| BALANCE AT DECEMBER 31, 2004   | 1,584,648       | 3,384,761   |                         | 23,323,955           |              |
| Comprehensive income:  |                 |             |                         |                      |              |
| Net income   | --              | --          | \$2,225,558             | 2,225,558            |              |
| Change in net unrealized gain on<br>investment securities available-<br>for-sale, net of reclassification<br>adjustment and tax effects    | --              | --          | (516,630)               | --                   | (            |
| Total comprehensive income   |                 |             | \$1,708,928             |                      |              |
| Issuance of 8,619 shares of common<br>stock under dividend reinvestment  |                 |             |                         |                      |              |



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|   |             |             |              |       |
|---|-------------|-------------|--------------|-------|
| and stock purchase plans                      | 10,773      | 224,941     | --           |       |
| Purchase of 18,000 shares of treasury stock   | --          | --          | --           |       |
| Retirement of 18,000 shares of treasury stock | (22,500)    | (483,200)   | --           |       |
| Cash dividends \$.74 per share                | --          | --          | (933,013)    |       |
|   | -----       | -----       | -----        | ----- |
| BALANCE AT DECEMBER 31, 2005                  | \$1,572,921 | \$3,126,502 | \$24,616,500 | \$ (  |
|   | -----       | -----       | -----        | ----- |

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

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CCFNB BANCORP, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

|  | 2005             | 2004             | 2003             |
|--|------------------|------------------|------------------|
|  | -----            | -----            | -----            |
| <b>OPERATING ACTIVITIES</b>  |                  |                  |                  |
| Net income   | \$ 2,225,558     | \$ 2,217,413     | \$ 2,217,413     |
| Adjustments to reconcile net income to net cash provided by operating activities:          |                  |                  |                  |
| Provision for loan losses  | 90,000           | 140,000          | 140,000          |
| Depreciation and amortization  | 414,214          | 374,664          | 374,664          |
| Premium amortization on investment securities  | 235,572          | 336,292          | 336,292          |
| Discount accretion on investment securities  | (11,666)         | (24,230)         | (24,230)         |
| Deferred income taxes (benefit)  | (79,970)         | 78,844           | 78,844           |
| (Gain) on sales of investment securities available-for-sale                                | (33,947)         | (3,537)          | (3,537)          |
| (Gain) on sale of mortgage loans   | (40,046)         | (35,959)         | (35,959)         |
| Proceeds from sale of mortgage loans   | 1,747,367        | 1,895,310        | 1,895,310        |
| Originations of mortgage loans for resale  | (1,707,320)      | (2,137,886)      | (2,137,886)      |
| (Gain) loss on sales of other real estate owned  | --               | 3,180            | 3,180            |
| (Gain) from investment in insurance agency   | (11,366)         | (17,248)         | (17,248)         |
| (Increase) decrease in accrued interest receivable   | (143,058)        | (5,368)          | (5,368)          |
| (Increase) decrease in other assets - net  | 84,212           | (95,298)         | (95,298)         |
| Net (increase) in cash surrender value of bank owned life insurance                        | (281,036)        | (291,247)        | (291,247)        |
| Increase (decrease) in accrued interest and other expenses                                 | 173,204          | 81,794           | 81,794           |
| Increase (decrease) in other liabilities - net   | (27,483)         | 20,889           | 20,889           |
|  | -----            | -----            | -----            |
| <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>   | <b>2,634,235</b> | <b>2,537,613</b> | <b>2,537,613</b> |
|  | -----            | -----            | -----            |
| <b>INVESTING ACTIVITIES</b>  |                  |                  |                  |
| Purchase of investment securities available-for-sale                                       | (4,949,870)      | (24,794,418)     | (24,794,418)     |
| Proceeds from sales, maturities and redemption of investment securities available-for-sale | 11,891,868       | 25,154,814       | 25,154,814       |
| Proceeds from sales of other real estate owned   | --               | 32,516           | 32,516           |
| Net (increase) decrease in loans   | (4,300,909)      | (2,154,069)      | (2,154,069)      |
| Purchase of premises and equipment   | (732,328)        | (610,832)        | (610,832)        |
| Purchase of bank owned life insurance policies   | --               | --               | --               |

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|   |              |               |        |
|---|--------------|---------------|--------|
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | 1,908,761    | (2,371,989)   | (8,    |
| FINANCING ACTIVITIES                                |              |               |        |
| Net increase (decrease) in deposits                 | (7,640,251)  | 701,468       | (      |
| Net increase in short-term borrowings               | 2,842,325    | 767,167       | 3,     |
| Repayment of long-term borrowings                   | (12,774)     | (12,034)      |        |
| Acquisition of treasury stock                       | (505,700)    | (467,000)     |        |
| Proceeds from issuance of common stock              | 235,714      | 206,245       |        |
| Cash dividends paid                                 | (933,013)    | (890,997)     | (      |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | (6,013,699)  | 304,849       | 2,     |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS    | (1,470,703)  | 470,473       | (3,    |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR      | 12,832,527   | 12,362,054    | 16,    |
| CASH AND CASH EQUIVALENTS AT END OF YEAR            | \$11,361,824 | \$ 12,832,527 | \$ 12, |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION   |              |               |        |
| Cash paid during the year for:                      |              |               |        |
| Interest  | \$ 4,084,220 | \$ 3,698,805  | \$ 4,  |
| Income taxes  | \$ 635,267   | \$ 569,349    | \$     |

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

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CCFNB BANCORP, INC. AND SUBSIDIARY  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of CCFNB Bancorp, Inc. and Subsidiary (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, Columbia County Farmers National Bank (the "Bank"). All significant inter-company balances and transactions have been eliminated in consolidation.

#### NATURE OF OPERATIONS & LINES OF BUSINESS

The Corporation provides full banking services, including trust services, through the Bank, to individuals and corporate customers. The Bank has seven offices covering an area of approximately 484 square miles in Northcentral Pennsylvania. The Corporation and its banking subsidiary are subject to the regulation of the Office of the Comptroller of the Currency, 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 the loans are mainly real estate loans covering primary residences and small business enterprises. The trust services, under the name of CCFNB and Co., include

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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.

On December 19, 2000, the Corporation became a Financial Holding Company by having filed an election to do so with the Federal Reserve Board. The Financial Holding Company status was required in order to acquire an interest in a local insurance agency that occurred during January 2001.

### SEGMENT REPORTING

The Corporation's banking subsidiary 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, internet 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 Trust Department as well as offering 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 income and expenses during the reporting periods. Actual results could differ from those 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.

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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 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

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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.

### 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. These loans are sold with limited recourse to the Corporation.

Past Due 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 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.

Non-Accrual 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 collectibility of principal or interest, even though the loan currently is 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 collectibility of principal.

Impaired Loans - 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

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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, 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.

### DERIVATIVES

The Bank has outstanding loan commitments that relate to the origination of mortgage loans that will be held for resale. Pursuant to Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities", SFAS No. 149, "Amendment of Statement 133 on Derivative and Hedging Activities" and the guidance contained in the Derivatives Implementation Group Statement 133 Implementation Issue No. C 13, the Bank has accounted for such loan commitments as

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derivative instruments. The effective date of the implementation guidance is the first day of the first fiscal quarter beginning after April 10, 2002. The outstanding loan commitments in this category did not give rise to any losses for the years December 31, 2005, 2004 and 2003, as the fair market value of each outstanding loan commitment exceeded the Bank's cost basis in each loan commitment.

### 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 Corporation originates and sells real estate loans to investors in the secondary mortgage market. After the sale, the Corporation retains the right to service 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.

### 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

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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.

### BANK OWNED LIFE INSURANCE

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

### INVESTMENT IN INSURANCE AGENCY

On January 2, 2001, the Corporation acquired a 50% interest in a local insurance agency, a corporation organized under the laws of the Commonwealth of Pennsylvania. The income or loss from this investment is accounted for under the equity method of accounting. The carrying value of this investment as of December 31, 2005 and 2004 is \$198,909 and \$187,543, respectively, and is carried in other assets in the accompanying consolidated balance sheets.

### 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.

### PER SHARE DATA

Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings Per Share", requires dual presentation of basic and diluted earnings per share. Basic earnings per share is 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 is 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, 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

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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.

### 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

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because such items are not assets of the Corporation. Trust Department income is generally recognized on a cash basis and is not materially different than if it was reported on an accrual basis.

### RECENT ACCOUNTING PRONOUNCEMENTS

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP)115 - "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments". This FSP provides additional guidance on when an investment in a debt or equity security should be considered impaired and when that impairment should be considered other-than-temporary and recognized as a loss in the consolidated statement of income. Specifically, this guidance clarifies that an investor should recognize an impairment loss no later than when an impairment is deemed other-than-temporary, even if the decision to sell has not been made. The FSP also requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The Corporation has followed the guidance of this FSP in 2005.

In May 2005, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 154 "Accounting Changes and Error Corrections" which modifies the accounting for and reporting of a change in an accounting principle. This statement applies to all voluntary changes in accounting principles and changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. This statement also requires retrospective application to prior period financial statements of changes in accounting principles, unless it is impractical to determine either the period-specific or cumulative effects of the accounting change. SFAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 is not expected to have a material impact on the Corporation's consolidated financial condition or results of operation.

In December 2004, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 153, "Exchanges of Nonmonetary Assets", which amends APB Opinion No. 29, "Accounting for Nonmonetary Transactions". SFAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in Opinion No. 29 and replaces it with an exception for exchanges that do not have commercial substance. SFAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have a material impact on the Corporation's consolidated financial condition or results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment". This Statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation", and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and its related guidance. SFAS No. 123 (revised 2004) established standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This Statement established fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees, except for equity instruments held by employee share ownership plans.

In addition, this statement amends SFAS No. 95 "Statement of Cash Flows" to require that excess tax benefits be reported as financing cash inflow rather than as a reduction of taxes paid. The Corporation will be required to adopt these statements as of January 1, 2006. SFAS 123R will require the Corporation to change its method of accounting for share-based awards to include estimated

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forfeitures in the initial estimate of compensation expense and to accelerate the recognition of compensation expense for retiree-eligible employees. The adoption of these standards is not expected to have a material effect on the Corporation's consolidated financial condition or results of operations.

### ADVERTISING COSTS

It is the Corporation's policy to expense advertising costs in the period in which they are incurred. Advertising expense for the years ended December 31, 2005, 2004 and 2003, was approximately \$81,751, \$86,328 and \$75,434, respectively.

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### RECLASSIFICATIONS

Certain amounts in the consolidated financial statements of the prior years have been reclassified to conform with presentations used in the 2005 consolidated financial statements. Such reclassifications had no effect on the Corporation's consolidated financial condition or net income.

### 2. RESTRICTED CASH BALANCES

The Bank is required to maintain average reserve balances with the Federal Reserve Bank. The amount required at December 31, 2005 was \$1,219,000 and was satisfied by vault cash. Additionally, as compensation for check clearing and other services, compensating balances are required to be maintained with the Federal Reserve Bank and other correspondent banks. At December 31, 2005, these balances were \$741,000.

### 3. INVESTMENT SECURITIES AVAILABLE-FOR-SALE

The amortized cost, related estimated fair value, and unrealized gains and losses for investment securities were as follows at December 31, 2005 and 2004:

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estima<br>Fair<br>Valu |
|---|-------------------|------------------------------|-------------------------------|------------------------|
|   | -----             | -----                        | -----                         | -----                  |
| DECEMBER 31, 2005:  |                   |                              |                               |                        |
| Obligation of U.S. Government Corporations<br>and Agencies: |                   |                              |                               |                        |
| Mortgage-backed   | \$22,935,558      | \$ 34,402                    | \$406,156                     | \$22,563               |
| Other   | 21,497,710        | 6,274                        | 347,137                       | 21,156                 |
| Obligations of state and political subdivisions             | 7,688,869         | 100,267                      | 7,018                         | 7,782                  |
| Marketable equity securities                                | 1,105,426         | 183,582                      | 24,059                        | 1,264                  |
| Restricted equity securities                                | 1,151,600         | --                           | --                            | 1,151                  |
|   | -----             | -----                        | -----                         | -----                  |
| Total   | \$54,379,163      | \$324,525                    | \$784,370                     | \$53,919               |
|   | =====             | =====                        | =====                         | =====                  |
| DECEMBER 31, 2004:  |                   |                              |                               |                        |
| Obligation of U.S. Government Corporations<br>and Agencies: |                   |                              |                               |                        |
| Mortgage-backed   | \$32,119,791      | \$127,903                    | \$226,683                     | \$32,021               |
| Other   | 18,250,000        | 11,332                       | 126,250                       | 18,135                 |
| Obligations of state and political subdivisions             | 8,698,272         | 236,944                      | 5,678                         | 8,929                  |
| Marketable equity securities                                | 1,072,858         | 313,196                      | 7,834                         | 1,378                  |



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|                              |              |           |           |          |
|------------------------------|--------------|-----------|-----------|----------|
| Restricted equity securities | 1,370,200    | --        | --        | 1,370    |
|                              | -----        | -----     | -----     | -----    |
| Total                        | \$61,511,121 | \$689,375 | \$366,445 | \$61,834 |
|                              | =====        | =====     | =====     | =====    |

Securities available-for-sale with an aggregate fair value of \$45,085,281 and \$40,299,434 at December 31, 2005 and 2004, respectively, were pledged to secure public funds, trust funds, securities sold under agreements to repurchase and other balances of \$31,266,889 and \$28,168,191 at December 31, 2005 and 2004, respectively, as required by law.

The amortized cost and estimated fair value of debt securities, by expected maturity, are shown below at December 31, 2005. Expected maturities 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, marketable equity securities and restricted equity securities are not considered to have defined maturities and are included in the "Due after ten years" category:

|  | Amortized<br>Cost | Estimated<br>Fair<br>Value | Weighted<br>Average<br>Yield |
|--|-------------------|----------------------------|------------------------------|
|  | -----             | -----                      | -----                        |
| Due in one year or less                | \$ 3,842,438      | \$ 3,781,290               | 2.64%                        |
| Due after one year through five years  | 37,343,120        | 36,701,839                 | 3.77%                        |
| Due after five years through ten years | 7,970,720         | 8,028,328                  | 6.54%                        |
| Due after ten years                    | 5,222,885         | 5,407,861                  | 4.91%                        |
|  | -----             | -----                      |                              |
| Total                                  | \$54,379,163      | \$53,919,318               | 4.20%                        |
|  | =====             | =====                      |                              |

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Restricted equity securities consist of stock in the Federal Home Loan Bank of Pittsburgh (FHLB), Federal Reserve Bank (FRB) and Atlantic Central Bankers Bank (ACBB) and do not have a readily determinable fair value for purposes of SFAS No. 115, because their ownership is restricted, and they can be sold back only to the FHLB, FRB, ACBB or to another member institution. Therefore, these securities are classified as restricted equity investment securities, carried at cost, and evaluated for impairment.

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 December 31, 2005. 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.

Proceeds from sales, maturities and redemptions of investments in debt and equity securities classified as available-for-sale during 2005, 2004 and 2003 were \$11,749,781, \$25,154,814 and \$40,408,337, respectively. Gross gains realized on these sales were \$33,947, \$3,537 and \$8,369, respectively. There

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were no gross losses on the 2005, 2004 and 2003 sales.

In accordance with disclosures required by EITF No. 03-01, the summary below shows the gross unrealized losses and fair value, aggregated by investment category that individual securities have been in a continuous unrealized loss position for less than or more than 12 months as of December 31, 2005 and 2004:

| Description of Security<br>-----                | Less than 12 months<br>----- |                             | 12 months or more<br>----- |                             |
|---|------------------------------|-----------------------------|----------------------------|-----------------------------|
|   | Fair Value<br>-----          | Unrealized<br>Loss<br>----- | Fair Value<br>-----        | Unrealized<br>Loss<br>----- |
| DECEMBER 31, 2005:                              |                              |                             |                            |                             |
| Obligations of U.S. Government                  |                              |                             |                            |                             |
| Corporations and Agencies:                      |                              |                             |                            |                             |
| Mortgage-backed                                 | \$ 8,735,755                 | \$103,233                   | \$ 9,768,969               | \$302,                      |
| Other   | 4,456,955                    | 40,755                      | 15,443,618                 | 306,                        |
| Obligations of state and political subdivisions | 669,727                      | 7,018                       | --                         |                             |
| Marketable Equity Securities                    | 398,001                      | 10,442                      | 30,573                     | 13,                         |
|   | -----                        | -----                       | -----                      | -----                       |
| Total   | \$14,260,438                 | \$161,448                   | \$25,243,160               | \$622,                      |
|   | =====                        | =====                       | =====                      | =====                       |
| DECEMBER 31, 2004:                              |                              |                             |                            |                             |
| Obligations of U.S. Government                  |                              |                             |                            |                             |
| Corporations and Agencies:                      |                              |                             |                            |                             |
| Mortgage-backed                                 | \$ 678,939                   | \$ 5,678                    | \$ --                      | \$ 69,                      |
| Other   | 16,763,135                   | 157,165                     | 3,412,092                  |                             |
| Obligations of state and political subdivisions | 15,623,750                   | 126,250                     | --                         |                             |
| Marketable Equity Securities                    | --                           | --                          | 90,630                     | 7,                          |
|   | -----                        | -----                       | -----                      | -----                       |
| Total   | \$33,065,824                 | \$289,093                   | \$ 3,502,722               | \$ 77,                      |
|   | =====                        | =====                       | =====                      | =====                       |

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's marketable equity securities represent common stock positions in various financial institutions. The fair market value of these equities tends to fluctuate with the overall equity markets as well as the trends specific to each institution.

The Corporation has both the intent and ability to hold the securities contained in the previous table for a time necessary to recover the cost.

#### 4. LOANS

Major classifications of loans at December 31, 2005 and 2004 consisted of:

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|                                     | 2005          | 2004          |
|-------------------------------------|---------------|---------------|
|                                     | -----         | -----         |
| Commercial                          | \$ 12,096,894 | \$ 12,181,900 |
| Tax-exempt                          | 9,018,852     | 10,061,809    |
| Real estate - construction          | 1,548,536     | 733,642       |
| Real estate                         | 127,170,180   | 122,104,012   |
| Personal                            | 4,347,575     | 4,738,159     |
|                                     | -----         | -----         |
| Total gross loans                   | 154,182,037   | 149,819,522   |
| Add (Deduct): Unearned discount     | (29,824)      | (46,195)      |
| Unamortized loan costs, net of fees | 119,149       | 126,374       |
|                                     | -----         | -----         |
| Loans, net of unearned income       | \$154,271,362 | \$149,899,701 |
|                                     | =====         | =====         |

Real estate loans held-for-sale in the amount of \$0 at December 31, 2005 and \$268,886 at December 31, 2004 are included in 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 loan balances at December 31, 2005 and 2004 are \$35,080 and \$55,338, respectively.

Non-accrual loans at December 31, 2005, 2004 and 2003 were \$706,800, \$1,240,616 and \$1,851,686, respectively. The gross interest that would have been recorded if these loans had been current in accordance with their original terms and the amounts actually recorded in income were as follows:

|                                | 2005     | 2004      | 2003      |
|--------------------------------|----------|-----------|-----------|
|                                | -----    | -----     | -----     |
| Gross interest due under terms | \$87,105 | \$129,182 | \$142,873 |
| Amount included in income      | 28,215   | 86,834    | 17,586    |
|                                | -----    | -----     | -----     |
| Interest income not recognized | \$58,890 | \$ 42,348 | \$125,287 |
|                                | =====    | =====     | =====     |

At December 31, 2005, 2004 and 2003 the recorded investment in loans that are considered to be impaired as defined by SFAS No. 114 was \$574,485, \$1,240,616 and \$1,594,835, respectively. No additional charge to operations was required to provide for the impaired loans specifically allocated allowance of \$127,535, \$289,942 and \$192,408, respectively at December 31, 2005, 2004 and 2003, since the total allowance for loan losses is estimated by management to be adequate to provide for the loan loss allowance required by SFAS No. 114 along with any other potential losses. The average recorded investment in impaired loans during the years ended December 31, 2005, 2004 and 2003 was approximately \$902,384, \$1,463,372 and \$1,708,208, respectively.

Loans past due 90 days or more and still accruing interest amounted to \$130,044 at December 31, 2005 and \$20,217 at December 31, 2004, as presented in accordance with AICPA Statement of Position 01-06, "Accounting by Certain Entities (Including Entities with Trade Receivables) that Lend to or Finance the Activities of Others," effective for fiscal years beginning after December 15, 2001.

At December 31, 2005, there were no significant commitments to lend additional funds with respect to non-accrual and restructured loans.

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Changes in the allowance for loan losses for the years ended December 31, 2005, 2004 and 2003 were as follows:

|                                 | 2005<br>-----        | 2004<br>-----        | 2003<br>-----        |
|---------------------------------|----------------------|----------------------|----------------------|
| Balance, beginning of year      | \$1,391,826          | \$1,415,431          | \$1,298,406          |
| Provision charged to operations | 90,000               | 140,000              | 200,000              |
| Loans charged-off               | (54,306)             | (203,430)            | (128,452)            |
| Recoveries                      | 125,056              | 39,825               | 45,477               |
|                                 | -----                | -----                | -----                |
| Balance, end of year            | \$1,552,576<br>===== | \$1,391,826<br>===== | \$1,415,431<br>===== |

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### 5. MORTGAGE SERVICING RIGHTS

The Corporation commenced selling real estate mortgages during the last quarter of 2002. The mortgage loans sold serviced for others are not included in the accompanying Consolidated Balance Sheets. The unpaid principal balances of mortgage loans serviced for others were \$9,794,711 and \$9,788,738 at December 31, 2005 and 2004, respectively. The balances of amortized mortgage servicing rights included in other assets at December 31, 2005 and 2004 were \$36,366 and \$54,207, respectively. Valuation allowances were not provided since fair values were determined to exceed carrying values. Fair values were determined using a discount rate of 6% and average lives of 3 to 6 years depending on loan rate.

The following summarizes mortgage servicing rights capitalized and amortized:

|                           | 2005<br>-----      | 2004<br>-----      |
|---------------------------|--------------------|--------------------|
| Balance, January 1        | \$ 54,207          | \$ 75,097          |
| Servicing asset additions | 5,760              | 7,600              |
| Amortization              | (23,601)           | (28,490)           |
|                           | -----              | -----              |
| Balance, December 31      | \$ 36,366<br>===== | \$ 54,207<br>===== |

The Bank does not require custodial escrow accounts in connection with the foregoing loan servicing.

### 6. PREMISES AND EQUIPMENT

A summary of premises and equipment at December 31, 2005 and 2004 follows:

|  | 2005<br>----- | 2004<br>----- |
|--|---------------|---------------|
|--|---------------|---------------|

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|                                |             |             |
|--------------------------------|-------------|-------------|
| Land                           | \$ 762,541  | \$ 567,939  |
| Buildings and improvements     | 4,928,312   | 4,574,420   |
| Furniture and equipment        | 3,536,405   | 4,535,624   |
|                                | -----       | -----       |
|                                | 9,227,258   | 9,677,983   |
| Less: Accumulated depreciation | 4,390,519   | 5,159,358   |
|                                | -----       | -----       |
|                                | \$4,836,739 | \$4,518,625 |
|                                | =====       | =====       |

Depreciation amounted to \$414,214, \$374,664 and \$379,733 in 2005, 2004 and 2003, respectively.

7. DEPOSITS

Major classifications of deposits at December 31, 2005 and 2004 consisted of:

|                               | 2005          | 2004          |
|-------------------------------|---------------|---------------|
|                               | -----         | -----         |
| Demand - non-interest bearing | \$ 18,249,315 | \$ 18,687,440 |
| Demand - interest bearing     | 28,858,627    | 30,572,645    |
| Savings                       | 34,767,792    | 37,825,629    |
| Time \$100,000 and over       | 25,627,611    | 26,329,758    |
| Other time                    | 57,343,513    | 59,071,637    |
|                               | -----         | -----         |
| Balance, December 31          | \$164,846,858 | \$172,487,109 |
|                               | =====         | =====         |

The following is a schedule reflecting remaining maturities of time deposits of \$100,000 and over at December 31, 2005:

|                     |              |
|---------------------|--------------|
| 2006                | \$12,582,634 |
| 2007                | 5,214,406    |
| 2008                | 4,362,957    |
| 2009                | 2,029,286    |
| 2010 and thereafter | 1,438,328    |
|                     | -----        |
| Total               | \$25,627,611 |
|                     | =====        |

Interest expense related to time deposits of \$100,000 or more was \$910,413 in 2005, \$914,663 in 2004 and \$1,208,973 in 2003.

8. 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

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demand. Short-term borrowings consisted of the following at December 31, 2005 and 2004:

|  | 2005                |                          |                           |              |                     | Ending Balance |  |
|--|---------------------|--------------------------|---------------------------|--------------|---------------------|----------------|--|
|  | Ending Balance      | Weighted Average Balance | Maximum Month End Balance | Average Rate | Ending Balance      |                |  |
| Securities sold under agreements to repurchase | \$24,052,474        | \$20,639,634             | \$24,052,474              | 2.97%        | \$21,175,411        | \$1            |  |
| U.S. Treasury tax and loan notes               | 547,237             | 295,796                  | 893,842                   | 3.04%        | 581,975             |                |  |
| <b>Total</b>                                   | <b>\$24,599,711</b> | <b>\$20,935,430</b>      | <b>\$24,946,316</b>       | <b>2.98%</b> | <b>\$21,757,386</b> | <b>\$1</b>     |  |

9. LONG-TERM BORROWINGS

Long-term borrowings consist of advances due Federal Home Loan Bank. Under terms of a blanket agreement, the loans were secured by certain qualifying assets of the Bank which consisted principally of first mortgage loans and certain investment securities. The carrying value of these collateralized items was \$11,310,669 at December 31, 2005. The Bank has lines of credit with Atlantic Central Bankers Bank and Federal Home Loan Bank in the aggregate amount of \$25,000,000 at December 31, 2005. The unused portions of these lines of credit were \$8,689,331 and \$5,000,000, respectively at December 31, 2005. Long-term borrowings consisted of the following at December 31, 2005 and 2004:

|  | 2005       | 2004 |
|--|------------|------|
| Loan dated November 28, 1997 in the original amount of \$225,000 for a 10 year term requiring monthly payments of \$1,627 including interest at 6.12%, maturing in 2007 with a final payment due of \$146,690. Principal balances outstanding.                   | \$ 165,730 | \$ 1 |
| Loan dated February 18, 1998 in the original amount of \$2,000,000 for a 10 year term with a 5 year put Interest only is payable monthly at 5.48% with a floating rate option, at the discretion of FHLB, at the end of 5 years. Principal balances outstanding. | 2,000,000  | 2,0  |
| Loan dated June 25, 1998 in the original amount of \$72,000 for a 30 year term requiring monthly payments of \$425 including interest at 5.856%. Principal balances outstanding.   | 63,814     |      |
| Loan dated February 23, 1999 in the original amount of \$29,160 for a 20 year term requiring monthly payments of \$179 including interest at 5.50%. Principal balances outstanding.  | 24,651     |      |
| Loan dated August 20, 1999 in the original amount of \$32,400 for a 20 year term requiring monthly payments of \$199 including interest at 5.50%. Principal balances outstanding.  | 27,825     |      |
| Loan dated January 27, 2000 in the original amount of \$5,000,000 for a 10 year term with a 1 year conversion date, at the discretion of FHLB, and a 3 month conversion  |            |      |

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|   |              |        |
|---|--------------|--------|
| frequency thereafter. At December 31, 2005 the interest rate was 6.00%.<br>Principal balances outstanding.  | 5,000,000    | 5,0    |
| Loan dated August 16, 2000 in the original amount of \$2,000,000<br>for a 10 year term with a 6 month conversion date,<br>at the discretion of FHLB, and a 3 month conversion<br>frequency thereafter. At December 31, 2005 the interest rate was 5.925%.<br>Principal balances outstanding.  | 2,000,000    | 2,0    |
| Loan dated September 20, 2000 in the original amount of \$2,000,000<br>for a 10 year term with a 3 year conversion date,<br>at the discretion of FHLB, and a 3 month conversion<br>frequency thereafter. At December 31, 2005 the interest rate was 6.10%.<br>Principal balances outstanding. | 2,000,000    | 2,0    |
| Loan dated December 13, 2000 in the original amount of \$32,092<br>for a 20 year term requiring monthly payments of \$197<br>including interest at 5.50%.<br>Principal balances outstanding.  | 28,649       |        |
|   | -----        | -----  |
| Total   | \$11,310,669 | \$11,3 |
|   | =====        | =====  |

At December 31, 2005 the annual maturities of long-term debt were as follows: \$13,559 in 2006, \$160,202 in 2007, \$2,004,366 in 2008, \$4,619 in 2009, \$9,004,885 in 2010 and \$123,038 thereafter.

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### 10. COMPREHENSIVE INCOME

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

|  | Years Ended December 31, |             |             |
|--|--------------------------|-------------|-------------|
|  | 2005                     | 2004        | 2003        |
|  | -----                    | -----       | -----       |
| Unrealized holding gains (losses) on available-for-sale<br>investment securities | \$(816,725)              | \$(275,155) | \$(230,183) |
| Reclassification adjustment for gains realized in income                         | 33,947                   | 3,537       | 8,369       |
|  | -----                    | -----       | -----       |
| Change in unrealized gains (losses) before tax effect                            | (782,778)                | (271,618)   | (221,814)   |
| Tax effect   | 266,148                  | 109,056     | 60,711      |
|  | -----                    | -----       | -----       |
| Net change in unrealized gains (losses)  | \$(516,630)              | \$(162,562) | \$(161,103) |
|  | =====                    | =====       | =====       |

### 11. STOCKHOLDERS' EQUITY AND STOCK PURCHASE PLANS

The Amended Articles of Incorporation contain a provision that permits the Corporation to issue warrants for the purchase of shares of common stock, par value \$1.25 per share (the "Common Stock"), at below market prices in the event any person or entity acquires 25% or more of the Common Stock.

The Corporation offers employees a stock purchase plan. The maximum number of shares of the Common Stock to be issued under this plan shall be 20,000. In

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addition, the Corporation may choose to purchase shares on the open market to facilitate this plan. A participating employee may annually elect deductions of at least 1% of base pay, but not more than 10% of base pay, to cover purchases of shares under this plan. A participating employee shall be deemed to have been granted an option to purchase a number of shares of the Common Stock equal to the annual aggregate amount of payroll deductions elected by the employee divided by 90% of the fair market value of Common Stock on the first day of January in each year. Stock issued to participating employees under the plan for the most recent three year period were:

|              | Per Share           |                                 |                              |
|--------------|---------------------|---------------------------------|------------------------------|
|              | Number<br>of Shares | Employees'<br>Purchase<br>Price | Market<br>Value<br>of Shares |
|              | -----               | -----                           | -----                        |
| Date Issued: |                     |                                 |                              |
| 2005         | 365                 | \$24.52                         | \$27.24                      |
| 2004         | 469                 | \$25.20                         | \$28.00                      |
| 2003         | 641                 | \$21.22                         | \$23.58                      |

The Corporation also offers to its stockholders a Dividend Reinvestment and Stock Purchase Plan. Under the plan, the Corporation registered with the Securities and Exchange Commission 500,000 shares of the Common Stock to be sold pursuant to the plan. The price per share for purchases under this plan is determined at each quarterly dividend payment date by the reported average mean between the bid and asked prices for the shares at the close of trading in the over-the-counter market on the trading day immediately preceding the quarterly dividend payment date. Participation in this plan by Shareholders began in June 1995. Shares issued under this plan for the most recent three year period were:

|       | Number<br>of Shares | Total<br>Proceeds |
|-------|---------------------|-------------------|
|       | -----               | -----             |
| Year: |                     |                   |
| 2005  | 8,254               | \$226,765         |
| 2004  | 6,804               | \$194,425         |
| 2003  | 7,068               | \$180,193         |

### 12. INCOME TAXES

The provision for income tax expense consisted of the following components:

|          | 2005      | 2004      | 2003      |
|----------|-----------|-----------|-----------|
|          | -----     | -----     | -----     |
| Federal: |           |           |           |
| Current  | \$710,482 | \$522,267 | \$648,349 |



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|                           |           |           |           |
|---------------------------|-----------|-----------|-----------|
| Deferred (benefit)        | (79,970)  | 79,146    | (57,728)  |
|                           | -----     | -----     | -----     |
|                           | 630,512   | 601,413   | 590,621   |
|                           | -----     | -----     | -----     |
| State:                    |           |           |           |
| Current                   | --        | --        | --        |
| Deferred (benefit)        | --        | (302)     | 486       |
|                           | -----     | -----     | -----     |
|                           | --        | (302)     | 486       |
|                           | -----     | -----     | -----     |
| Total Provision for Taxes | \$630,512 | \$601,111 | \$591,107 |
|                           | =====     | =====     | =====     |

A reconciliation of the actual provision for federal income tax expense and the amounts which would have been recorded based upon the statutory rate of 34% follows:

|  | 2005       |        | 2004       |        | 2003       |       |
|--|------------|--------|------------|--------|------------|-------|
|  | Amount     | % Rate | Amount     | % Rate | Amount     | %     |
|  | -----      | -----  | -----      | -----  | -----      | ----- |
| Provision at statutory rate            | \$ 971,064 | 34.0   | \$ 958,298 | 34.0   | \$ 936,361 |       |
| Tax-exempt income                      | (271,565)  | (9.5)  | (283,567)  | (10.1) | (282,067)  |       |
| Non-deductible expenses                | 24,830     | 0.8    | 23,262     | 0.8    | 26,314     |       |
| Bank-owned life insurance income - net | (83,992)   | (2.9)  | (87,464)   | (3.1)  | (84,094)   |       |
| Other, net                             | (9,825)    | (0.3)  | (9,116)    | (0.3)  | (5,893)    |       |
|  | -----      | -----  | -----      | -----  | -----      | ----- |
| Actual federal income tax and rate     | \$ 630,512 | 22.1   | \$ 601,413 | 21.3   | \$ 590,621 |       |
|  | =====      | =====  | =====      | =====  | =====      | ===== |

Income taxes applicable to realized security gains included in the provision for income taxes totaled \$11,542 in 2005, \$1,203 in 2004 and \$2,845 in 2003.

The net deferred tax asset recorded by the Corporation consisted of the following tax effects of temporary timing differences at December 31, 2005, 2004 and 2003:

|   | 2005       | 2004       | 2003       |
|---|------------|------------|------------|
|   | -----      | -----      | -----      |
| Deferred tax assets:                      |            |            |            |
| Allowance for loan losses                 | \$ 402,059 | \$ 371,459 | \$ 379,485 |
| Allowance for off balance sheet losses    | 3,230      | 3,230      | 1,530      |
| Deferred compensation and director's fees | 256,279    | 227,019    | 201,611    |
| Non-accrual loan interest                 | 20,023     | 12,704     | 33,260     |
| Mortgage Servicing Rights                 | 12,640     | 9,559      | 3,463      |
| Unrealized investment securities losses   | 156,347    | --         | --         |
|   | -----      | -----      | -----      |
| Total                                     | 850,578    | 623,971    | 619,349    |
|   | =====      | =====      | =====      |
| Deferred tax liabilities:                 |            |            |            |
| Loan fees and costs                       | (66,993)   | (75,993)   | (76,689)   |
| Accretion                                 | (1,320)    | (1,067)    | (986)      |
| Depreciation                              | (333,096)  | (337,924)  | (259,504)  |

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|  |            |           |           |
|--|------------|-----------|-----------|
| Investment in insurance agency         | (10,758)   | (6,894)   | (1,232)   |
| Unrealized investment securities gains | --         | (109,795) | (218,852) |
|  | -----      | -----     | -----     |
| Total                                  | (412,167)  | (531,673) | (557,263) |
|  | -----      | -----     | -----     |
| Net deferred tax asset                 | \$ 438,411 | \$ 92,298 | \$ 62,086 |
|  | =====      | =====     | =====     |

The above net deferred asset is included in other assets on the consolidated balance sheets. It is anticipated that all tax assets shown above will be realized, accordingly, no valuation allowance was provided.

The Corporation and its subsidiary file a consolidated federal income tax return. The Parent Company is also required to file a separate state income tax return and has available state operating loss carryforwards totaling \$716,595. The losses expire through 2025. The related deferred net state tax asset in the amount of \$52,491 has been fully reserved and is not reflected in the net tax asset since management is of the opinion that such assets will not be realized in the foreseeable future.

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### 13. EMPLOYEE BENEFIT AND DEFERRED COMPENSATION PLANS

#### EMPLOYEE BENEFIT PLANS

The Bank maintains a 401K salary deferred profit sharing plan for the benefit of its employees. Under the salary deferral component, employees may elect to contribute up to 25% of their compensation with the possibility that the Bank may make matching contributions to the plan. Under the profit sharing component, contributions are made at the discretion of the Board of Directors.

Matching contributions amounted to \$66,207, \$63,453 and \$64,088 in 2005, 2004 and 2003, respectively. There were no discretionary contributions in 2005, 2004 and 2003.

#### DEFERRED COMPENSATION PLANS

##### DIRECTORS

During 1990, the Bank entered into agreements with two directors to establish non-qualified deferred compensation plans for each of these directors. In 1994, additional plans were established for these two directors plus another director. These plans were limited to four-year terms. The Bank may, however, enter into subsequent similar plans with its directors. Each of the participating directors deferred the payment to himself of certain directors' fees to which he was entitled. Each director's future payment is based upon the cumulative amount of deferred fees together with interest currently accruing thereon at the rate of 8% per annum, subject to change by the Board of Directors. The total accrued liability as of December 31, 2005 and 2004 was \$210,768 and \$212,669, respectively, relating to these directors' deferred compensation agreements.

During 2003, the directors were given the option of receiving or deferring their directors' fees under a non-qualified deferred compensation plan which allows the director to defer such fees until the year following the expiration of the directors' term. Payments are then made over specified terms under these arrangements up to a ten year period. Interest is to accrue on these deferred

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fees at a five year certificate of deposit rate, which was 4% in 2004. The certificate of deposit rate will reset in January 2008. Two directors have elected to participate in this program and the total accrued liability as of December 31, 2005 and 2004 was \$73,422 and \$41,753, respectively.

Total directors fees, including amounts currently paid for the years ended December 31, 2005, 2004 and 2003 were \$189,833, \$147,152 and \$140,511, respectively, and the total accrued liability under the directors deferred compensation plans as of December 31, 2005 and 2004 was \$284,190 and \$254,422, respectively.

### EXECUTIVE OFFICERS

In 1992, the Bank entered into agreements with two executive officers to establish non-qualified deferred compensation plans. Each officer deferred compensation in order to participate in this Deferred Compensation Plan. If the officer continued to serve as an officer of the Bank until he attained sixty-five (65) years of age, the Bank agreed to pay him 120 guaranteed consecutive monthly payments commencing on the first day of the month following the officer's 65th birthday. Each officer's guaranteed monthly payment was based upon the future value of life insurance purchased with the compensation the officer has deferred. The Bank obtained life insurance (designating the Bank as the beneficiary) on the life of each participating officer in an amount which is intended to cover the Bank's obligations under the Deferred Compensation Plan, based upon certain actuarial assumptions.

During 2002, the agreements with the two executive officers were modified. Under one agreement, the executive officer will receive \$225,000 payable monthly over a 10 year period commencing in February 2003. Under another agreement, another executive officer will receive \$175,000 payable monthly over a 10 year period commencing in April 2003. This second agreement also provides post-employment health care benefits to the executive officer until the attainment of age 65. As of December 31, 2005 and 2004, the net cash value of insurance policies was \$370,986 and \$344,936, respectively, and the total accrued liability, equal to the present value of these obligations, was \$241,772 and \$269,418, respectively, relating to these executive officers' and directors' deferred compensation agreements, and the accrued liability related to the post-employment health care benefit was \$1,451 and \$9,024 as of December 31, 2005 and 2004, respectively.

In April 2003, the Bank entered into non-qualified deferred compensation agreements with three executive officers to provide supplemental retirement benefits commencing with the executive's retirement and ending 15 years thereafter. The deferred compensation expense related to these agreements for the years ended December 31, 2005 and 2004 was \$91,507 and \$79,710, respectively, and the total accrued liability as of December 31, 2005 and 2004 was \$226,348 and \$134,841, respectively.

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Total deferred compensation expense for current and retired executive officers for the years ended December 31, 2005, 2004 and 2003 was \$105,004, \$95,697 and \$73,714, respectively, and the total accrued liability under the executive officers' deferred compensation plans as of December 31, 2005 and 2004 was \$469,571 and \$413,283, respectively.

### 14. LEASE COMMITMENTS AND CONTINGENCIES

The Corporation's banking subsidiary entered into an operating lease on

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October 23, 2004 for the rental of a branch banking facility. The initial lease is for a term of five years, with two options available to renew for an additional term of five years each. Rent expense for this facility was \$28,000 for the year ended December 31, 2005. Minimum rental payments required under this lease are: 2006 - \$28,000, 2007 - \$28,000, 2008 - \$28,000, 2009 - \$22,957.

At December 31, 2005 the Bank was leasing some minor office equipment under operating leases.

Rental expense under operating leases for the years ended December 31, 2005, 2004 and 2003 was \$817, \$1,304 and \$2,778, respectively.

The Corporation's banking subsidiary entered into an operating lease on July 2, 2005 for the use of a 2005 GMC Yukon. The lease term is 36 months. Lease expense for the year ended December 31, 2005 was \$4,879. Minimum rental payments required are as follows: 2006 - \$7,175, 2007 - \$7,175, and 2008 - \$2,989.

A branch banking facility was acquired in 2005. It is expected to commence operation in the latter half of 2006. In connection with this new facility it is estimated that expenditures in 2006 will amount to approximately \$535,000 to make the facility operational.

In the normal course of business, there were various pending legal actions and proceedings which were not reflected in the consolidated financial statements. In the opinion of management, the consolidated financial statements have not and will not be affected materially by the outcome of such actions and proceedings.

### 15. RELATED PARTY TRANSACTIONS

Certain directors and executive officers of the Corporation and the Bank, as well as companies in which they are principal owners (i.e., at least 10% ownership), were indebted to the Bank at December 31, 2005 and 2004. These loans were made on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties. These loans did not present more than the normal risk of collectibility nor present other unfavorable features.

A summary of the activity on the related party loans, comprised of five directors, seven executive officers and their related companies, consisted of the following:

|                            | 2005         | 2004         |
|----------------------------|--------------|--------------|
|                            | -----        | -----        |
| Balance, beginning of year | \$ 1,538,734 | \$ 1,688,979 |
| Additions                  | 963,193      | 889,909      |
| Repayments                 | (1,256,081)  | (1,040,154)  |
|                            | -----        | -----        |
| Balance, end of year       | \$ 1,245,846 | \$ 1,538,734 |
|                            | =====        | =====        |

The above loans represent funds drawn and outstanding at the date of the accompanying consolidated financial statement. Commitments by the Bank to related parties on loan commitments and standby letters of credit for 2005 and 2004 presented an off-balance sheet risk to the extent of undisbursed funds in the amount of \$640,564 and \$441,353, respectively.

Deposits from certain officers and directors and/or their affiliated

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companies held by the Bank amounted to \$857,447 and \$955,028 at December 31, 2005 and 2004, respectively.

### 16. REGULATORY MATTERS

Dividends are paid by the Corporation to shareholders from its assets which are mainly provided by dividends from the Bank. However, national banking laws place certain restrictions on the amount of cash dividends allowed to be paid by the Bank to the Corporation. Generally, the limitation provides that dividend payments may not exceed the Bank's current year's retained income plus retained net income for the preceding two years. Accordingly, in 2006, without prior regulatory approval, the Bank may declare dividends to the Corporation in the amount of \$2,274,585 plus additional amounts equal to the net income earned in 2006 for the period January 1, 2006, through the date of declaration, less any dividends which may have already been paid in 2006. Regulations also limit the amount of loans and advances from the Bank to the Corporation to 10% of consolidated net assets.

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The Corporation is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Corporation's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation must meet specific capital guidelines that involve quantitative measures of the Corporation's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Corporation's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Management believes, as of December 31, 2005 and 2004, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier I Capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I Capital (as defined) to average assets (as defined).

As of December 31, 2005, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank 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 as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts (in thousands) and ratios are presented in the following table:

| Actual | For Capital<br>Adequacy Purposes | To Be Well<br>Capitalized Under<br>Prompt Corrective<br>Action Provisions |
|--------|----------------------------------|---|
| -----  | -----                            | -----   |

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|                           | Amount   | Ratio  | Amount   | Ratio | Amount   | Ratio  |
|---------------------------|----------|--------|----------|-------|----------|--------|
|                           | -----    | -----  | -----    | ----- | -----    | -----  |
| As of December 31, 2005:  |          |        |          |       |          |        |
| Total Risk-Based Capital  |          |        |          |       |          |        |
| (To risk-weighted assets) | \$30,950 | 20.32% | \$12,185 | 8.00% | \$15,231 | 10.00% |
| Tier I Capital            |          |        |          |       |          |        |
| (To risk-weighted assets) | \$29,315 | 19.24% | \$ 6,095 | 4.00% | \$ 9,142 | 6.00%  |
| Tier I Capital            |          |        |          |       |          |        |
| (To average assets)       | \$37,347 | 12.74% | \$11,726 | 4.00% | \$14,657 | 5.00%  |
| As of December 31, 2004:  |          |        |          |       |          |        |
| Total Risk-Based Capital  |          |        |          |       |          |        |
| (To risk-weighted assets) | \$30,027 | 20.31% | \$11,827 | 8.00% | \$14,784 | 10.00% |
| Tier I Capital            |          |        |          |       |          |        |
| (To risk-weighted assets) | \$28,488 | 19.27% | \$ 5,913 | 4.00% | \$ 8,870 | 6.00%  |
| Tier I Capital            |          |        |          |       |          |        |
| (To average assets)       | \$34,669 | 12.17% | \$11,394 | 4.00% | \$14,244 | 5.00%  |

The Corporation's capital ratios are not materially different from those of the Bank.

17. 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 December 31, 2005 and 2004 were as follows:

|   | 2005         | 2004         |
|---|--------------|--------------|
|   | -----        | -----        |
| Financial instruments whose contract amounts represent credit risk: |              |              |
| Commitments to extend credit  | \$20,417,688 | \$15,866,324 |
| Financial standby letters of credit                                 | 1,497,865    | 1,741,568    |
| Performance standby letters of credit                               | 570,307      | 846,260      |
| Dealer floor plans  | 1,042,843    | 852,161      |

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

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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 extent of collateral held for those commitments at December 31, 2005 varied from 0 percent to 100 percent; the average amount collateralized was 88.6 percent.

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 83.48% was for real estate loans, principally residential. It was the opinion of management that the high concentration did not pose an adverse credit risk. Further, it was management's opinion that the remainder of the loan portfolio was balanced and diversified to the extent necessary to avoid any significant concentration of credit.

### 18. FAIR VALUES OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards (SFAS) No. 107, "Disclosures about Fair Value of Financial Instruments", requires disclosure of fair value information about financial instruments, whether or not required to be recognized in the consolidated balance sheet, for which it is practicable to estimate such value. 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. SFAS No. 107 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.

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

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securities were estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers.

### 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.

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### DEPOSITS

Under SFAS No. 107, 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 December 31, 2005 and 2004.

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



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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.

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At December 31, 2005 and 2004, the carrying values and estimated fair values of financial instruments are presented in the table below:

|   | 2005               |                         | 2004               |
|---|--------------------|-------------------------|--------------------|
|   | Carrying<br>Amount | Estimated<br>Fair Value | Carrying<br>Amount |
| <b>Financial Assets:</b>                          |                    |                         |                    |
| Cash and short-term investments                   | \$ 11,361,824      | \$ 11,361,824           | \$ 12,832,527      |
| Investment securities                             | 53,919,318         | 53,919,318              | 61,834,051         |
| <b>Loans:</b>                                     |                    |                         |                    |
| Commercial  | 12,096,895         | 12,045,774              | 12,181,900         |
| Tax-exempt  | 9,018,852          | 8,909,839               | 10,061,809         |
| Real estate - construction                        | 1,548,536          | 1,555,311               | 733,642            |
| Real estate                                       | 127,170,179        | 127,027,330             | 122,104,012        |
| Personal  | 4,347,575          | 4,497,305               | 4,738,159          |
| Gross loans                                       | 154,182,037        | 154,035,559             | 149,819,522        |
| Add (Deduct): Unearned discount                   | (29,824)           | --                      | (46,195)           |
| Unamortized loan fees, net of costs               | 119,149            | --                      | 126,374            |
| Loans, net of unearned income                     | 154,271,362        | 154,035,559             | 149,899,701        |
| Allowance for losses                              | 1,552,576          | --                      | 1,391,826          |
| Net loans   | \$152,718,786      | \$154,035,559           | \$148,507,875      |
| Cash surrender value of bank owned life insurance | \$ 6,480,223       | \$ 6,480,223            | \$ 6,199,187       |
| <b>Financial Liabilities:</b>                     |                    |                         |                    |
| Deposits:   |                    |                         |                    |
| Demand - non-interest bearing                     | \$ 18,249,315      | \$ 18,249,315           | \$ 18,687,440      |
| Demand - interest bearing                         | 28,858,627         | 28,858,627              | 30,572,645         |
| Savings   | 34,767,792         | 34,767,792              | 37,825,629         |
| Time - \$100,000 and over                         | 25,627,611         | 25,399,928              | 26,329,758         |
| Other time  | 57,343,513         | 56,869,479              | 59,071,637         |
| Total Deposits                                    | \$164,846,858      | \$164,145,141           | \$172,487,109      |
| Short-Term Borrowings                             | \$ 24,599,711      | \$ 24,599,711           | \$ 21,757,386      |
| Long-Term Borrowings                              | 11,310,669         | 12,074,820              | 11,323,443         |
| <b>Off-Balance Sheet Assets (Liabilities):</b>    |                    |                         |                    |
| Commitments to extend credit                      |                    | \$ 20,417,688           |                    |
| Standby letters of credit                         |                    | 1,497,865               |                    |
| Performance standby letters of credit             |                    | 570,307                 |                    |
| Dealer floor plans                                |                    | 1,042,843               |                    |

## 19. PARENT COMPANY FINANCIAL INFORMATION

Condensed financial information for CCFNB Bancorp, Inc. (Parent Company only) was as follows:

| BALANCE SHEETS<br>-----                       | December 31,          |                       |
|---|-----------------------|-----------------------|
|   | 2005<br>-----         | 2004<br>-----         |
| Assets  |                       |                       |
| Cash  | \$ 155,207            | \$ 178,134            |
| Investment in subsidiary                      | 27,437,827            | 26,850,446            |
| Investment in other equity securities         | 1,264,946             | 1,378,220             |
| Prepayments and other assets                  | 198,909               | 245,276               |
| Receivable from subsidiary                    | 38,014                | --                    |
| Total Assets                                  | \$29,094,903<br>===== | \$28,652,076<br>===== |
| Liabilities and Stockholders' Equity          |                       |                       |
| Accrued expenses and other liabilities        | \$ 82,477             | \$ 110,717            |
| Payable to subsidiary                         | --                    | 34,862                |
| Total Liabilities                             | 82,477<br>-----       | 145,579<br>-----      |
| Stockholders' Equity                          |                       |                       |
| Common stock                                  | 1,572,921             | 1,584,648             |
| Surplus                                       | 3,126,502             | 3,384,761             |
| Retained earnings                             | 24,616,500            | 23,323,955            |
| Accumulated other comprehensive income (loss) | (303,497)             | 213,133               |
| Total Stockholders' Equity                    | 29,012,426<br>-----   | 28,506,497<br>-----   |
| Total Liabilities and Stockholders' Equity    | \$29,094,903<br>===== | \$28,652,076<br>===== |

| STATEMENTS OF INCOME<br>-----  | Years Ended Decem  |                  |
|--------------------------------|--------------------|------------------|
|                                | 2005<br>-----      | 2004<br>-----    |
| Income                         |                    |                  |
| Dividends from subsidiary bank | \$ 1,223,000       | \$ 967,7         |
| Dividends - other              | 40,660             | 37,2             |
| Securities gains               | 33,947             |                  |
| Other                          | --                 | 1                |
| Interest                       | 1,416              | 2,6              |
| Total Income                   | 1,299,023<br>----- | 1,007,7<br>----- |
| Operating expenses             | 109,927            | 97,0             |

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|  |              |            |
|--|--------------|------------|
| Income Before Taxes and Equity in Undistributed                  |              |            |
| Net Income of Subsidiary   | 1,189,096    | 910,7      |
| Applicable income tax (benefit)                                  | (17,340)     | (22,5      |
| Income Before Equity in Undistributed Net Income of Subsidiary   |              |            |
| and Equity in Income from Insurance Agency                       | 1,206,436    | 933,3      |
| Equity in (excess of) undistributed income of subsidiary         | 1,007,756    | 1,266,8    |
| Income from investment in insurance agency                       | 11,366       | 17,2       |
| Net Income   | \$ 2,225,558 | \$ 2,217,4 |
| STATEMENTS OF CASH FLOWS   |              |            |
| Operating Activities:  |              |            |
| Net income   | \$ 2,225,558 | \$ 2,217,4 |
| Adjustments to reconcile net income to net cash                  |              |            |
| provided by operating activities:                                |              |            |
| Deferred income taxes  | 3,864        | 5,6        |
| Securities gains   | (33,947)     |            |
| Distributions in excess of (equity in undistributed)             |              |            |
| net income of subsidiary   | (1,007,756)  | (1,266,8   |
| (Income) from investment in an insurance agency                  | (11,366)     | (17,2      |
| (Increase) decrease in prepayments and other assets              | 57,733       | (47,0      |
| (Increase) decrease in receivable from subsidiary                | (38,014)     | 35,1       |
| Increase (decrease) in payable to subsidiary                     | (34,862)     | 34,8       |
| Increase (decrease) in income taxes and accrued expenses payable | 17,482       |            |
| Net Cash Provided By Operating Activities                        | 1,178,692    | 961,9      |
| Investing Activities:  |              |            |
| Purchase of equity securities                                    | (140,707)    |            |
| Proceeds from sale of equity securities                          | 142,087      |            |
| Net Cash Provided By (Used In) Investing Activities              | 1,380        |            |
| Financing Activities:  |              |            |
| Acquisition of treasury stock                                    | (505,700)    | (467,0     |
| Proceeds from issuance of common stock                           | 235,714      | 206,2      |
| Cash dividends   | (933,013)    | (890,9     |
| Net Cash (Used In) Financing Activities                          | (1,202,999)  | (1,151,7   |
| Increase (Decrease) in Cash and Cash Equivalents                 | (22,927)     | (189,7     |
| Cash and Cash Equivalents at Beginning of Year                   | 178,134      | 367,9      |
| Cash and Cash Equivalents at End of Year                         | \$ 155,207   | \$ 178,1   |

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders of CCFNB Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of CCFNB Bancorp, Inc. and Subsidiary as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2005.

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These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CCFNB Bancorp, Inc. and Subsidiary as of December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

(J. H. WILLIAMS & CO., LLP)

J. H. Williams & Co., LLP  
Kingston, Pennsylvania  
January 13, 2006

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### ITEM 9A. CONTROLS AND PROCEDURES

**EVALUATION OF OUR DISCLOSURE CONTROLS AND INTERNAL CONTROLS.** We evaluated the effectiveness of the design and operation of our "disclosure controls and procedures" (Disclosure Controls), and our "internal controls and procedures for financial reporting" (Internal Controls). This evaluation (the Controls Evaluation) was done under the supervision and with the participation of management, including our Chief Executive Officer (CEO) and Chief Financial Officer (Treasurer). Rules adopted by the SEC require that, in this section of this report, we present the conclusions of the CEO and the Treasurer about the effectiveness of our Disclosure Controls and Internal Controls as of December 31, 2005.

**CEO AND CFO CERTIFICATIONS.** Appearing at Exhibits 31.1, 31.2, 32.1 and 32.2 of this report are two separate forms of "Certifications" for the CEO and the Treasurer. This section of this report which you are currently reading is the information concerning the Controls Evaluation referred to in the Section 302 Certification and this information should be read in conjunction with the Section 302 Certification for a more complete understanding of the topics presented.

**DISCLOSURE CONTROLS AND INTERNAL CONTROLS.** Disclosure Controls are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 (Exchange Act), such as this report, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and Treasurer, as appropriate, to allow timely decisions regarding required

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disclosure.

Our Company has created a disclosure committee. The committee consists of nine key management personnel. The purpose of the committee is to verify that all internal controls and procedures are in place in each area of authority. Whistle Blowing procedures have been put in place and communicated to all directors and employees. The disclosure committee meets quarterly before each quarter end.

We design Internal Controls procedures with the objective of providing reasonable assurance that: (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with generally accepted accounting principals.

LIMITATIONS ON THE EFFECTIVENESS OF CONTROLS. Our management, including the CEO and Treasurer, does not expect that our Disclosure Controls or our Internal Controls will prevent all error or all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits or controls must be considered relative to their costs. 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 and the Bank 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. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a control system may become inadequate because of changes in conditions, or the degree of compliance with the policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

SCOPE OF THE CONTROLS EVALUATION. The CEO and Treasurer evaluation of our Disclosure Controls and Internal Controls included a review of such controls' objectives and design, such control's implementation by us and the Bank and the effect of these controls on the information generated for use in this report. In the course of the Controls Evaluation, we sought to identify data errors, controls problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, were being undertaken. This type of evaluation will be done on a quarterly basis so that the conclusions concerning controls effectiveness can be reported in our Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K. Our Internal Controls are also evaluated on an ongoing basis by our outside internal auditors, by other personnel in the Bank and by our external independent auditors in connection with their audit and review activities. The overall goals of these various evaluation activities are to monitor our Disclosure Controls and Internal Controls and to make modifications as necessary. Our intent in this regard is that the Disclosure Controls and Internal Controls will be maintained as dynamic systems that change (including with improvements and corrections) as conditions warrant.

Among other matters, we sought in our evaluation to determine whether there were any "significant deficiencies" or "material weaknesses" in our and the Bank's Internal Controls, or whether we had identified any acts of fraud involving personnel who have a significant role in our and the Bank's Internal Controls. This information was important both for the Controls Evaluation generally and because items 5 and 6 in the Section 302 Certifications of the CEO and Treasurer

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require that the CEO and Treasurer disclose that information to our Board's Audit Committee and to our independent auditors and to report on related matters in this section of our Annual Report. In the professional auditing literature, "significant deficiencies" are referred to as "reportable conditions". These are control issues that could have a significant adverse effect on the ability to record, process, summarize and report financial data in the

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financial statements. A "material weakness" is defined in the auditing literature as a particularly serious reportable condition where the internal control does not reduce to a relatively low level the risk that misstatements caused by error or fraud may occur in amounts that would be material in relation to the financial statements and not be detected within a timely period by employees in the normal course of performing their assigned functions. In addition, we sought to deal with other controls matters in the Controls Evaluation, and in each case if a problem was identified, we considered what revision, improvement or correction to make in accord with our on-going procedures.

In accord with Commission requirements, the CEO and Treasurer note that, as of December 31, 2005, there have been no significant changes in Internal Controls or in other factors that could significantly affect Internal Controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

CONCLUSIONS. Based upon the Controls Evaluation, our CEO and Treasurer have concluded that, as of December 31, 2005, subject to the limitations noted above, our Disclosure Controls are effective to ensure that material information relating to CCFNB Bancorp, Inc. and its consolidated subsidiaries is made known to management, including the CEO and Treasurer, particularly during the period when our Exchange Act periodic reports are being prepared, and that our Internal Controls are effective as of December 31, 2005, to provide reasonable assurance that our financial statements are fairly presented in conformity with generally accepted accounting principles.

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

#### DIRECTORS

The Corporation has nine directors who are divided into three classes: three directors are in Class 1; three directors are in Class 2; and three directors are in Class 3. Each director holds office for a three-year term. The terms of the classes are staggered, so that the term of office of one class expires each year.

At this meeting, the stockholders elect three Class 3 directors. Unless you withhold authority to vote for one or more of the nominees, the persons named as proxies intend to vote for the election of the three nominees for Class 3 director. All of the nominees are recommended by the Board of Directors:

Edward L. Campbell  
Frank D. Gehrig  
Elwood R. Harding, Jr.

All nominees have consented to serve as directors. The Board of Directors has no reason to believe that any of the nominees should be unable to act as a director. However, if any director is unable to stand for re-election, the Board of Directors will designate a substitute. If a substitute nominee is named, the

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proxies will vote for the election of the substitute.

The following information includes the age of each nominee and current director as of the date of the meeting. All directors of the Corporation are also directors of the bank.

### CLASS 1 DIRECTORS WHOSE TERM EXPIRES IN 2008

ROBERT M. BREWINGTON, JR., 55

Director since 1996. Owner of Sutliff Motors and Brewington Transportation and a part owner of J&B Rentals (sales and service of cars and trucks; school bus contractor). Mr. Brewington is the brother of Sally Tucker, the bank's Marketing Director.

WILLARD H. KILE, JR., D.M.D., 51

Director since 2000. Partner of Kile & Robinson LLC (dentists); Partner of Kile & Kile Real Estate. Mr. Kile is a first cousin to Lance O. Diehl, our President and Chief Executive Officer.

CHARLES E. LONG, 70

Director since 1993. Retired. Former President of Long Supply Co., Inc. (a wholesaler and retailer of hardware and masonry products).

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### CLASS 2 DIRECTORS WHOSE TERM EXPIRES IN 2007

LANCE O. DIEHL, 40

Director since 2003. President and Chief Executive Officer of the Corporation and the bank. Former Executive Vice President of Branch Operations and Marketing of the bank. Mr. Diehl is a first cousin to Mr. Kile, a director.

WILLIAM F. HESS, 72

Director since 1983. Former Chairman of the Corporation and the bank. Dairy farmer.

PAUL E. REICHART, 68

Director since 1983. Chairman and former Vice Chairman of the Corporation and the bank. Former President and Chief Executive Officer of the Corporation and the bank.

### CLASS 3 DIRECTORS WHOSE TERM EXPIRES IN 2006 AND NOMINEES FOR CLASS 3 DIRECTORS WHOSE TERM WILL EXPIRE IN 2009

EDWARD L. CAMPBELL, 67

Director since 1985. Secretary of the Corporation and the bank. President of ELC Enterprises, Inc. and a partnerpartnerpartner of Heritage Acres, Christmas tree sales.

FRANK D. GEHRIG, 60

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Director since 2004. Partner in Accounting Firm of Brewer, Gehrig & Johnson, Certified Public Accountants.

ELWOOD R. HARDING, JR., 59

Director since 1984. Vice Chairman of the Corporation and the Bank. Attorney at law and President of Premier Real Estate Settlement Services, Inc. (title insurance).

### PRINCIPAL OFFICERS

Our principal officers are appointed by the Board of Directors and serve at the will of the Board of Directors, subject to certain change in control agreements discussed later in this report. The following information is presented for those persons who were principal officers at December 31, 2005:

| NAME & POSITION<br>-----                                 | HELD SINCE<br>----- | EMPLOYEE SINCE<br>----- | AGE<br>--- |
|--|---------------------|-------------------------|------------|
| Paul E. Reichart,<br>Chairman                            | 2004                | Employee<br>1960 - 2004 | 68         |
| Edward L. Campbell,,<br>Secretary                        | 2004                | *                       | 67         |
| Elwood R. Harding, Jr.,<br>Vice Chairman                 | 2004                | *                       | 59         |
| Lance O. Diehl,<br>President and Chief Executive Officer | 2004                | 1995                    | 40         |
| Virginia D. Kocher<br>Treasurer and Assistant Secretary  | 1991                | 1972                    | 58         |

\* Not an employee of the Company and the Bank.

### COMPLIANCE WITH SECTION 16(A) OF THE SECURITIES EXCHANGE ACT OF 1934

Executive officers and directors and "beneficial owners" of more than ten percent of the Common Stock must file initial reports of ownership and reports of changes in ownership with the SEC pursuant to Section 16(a) of the Securities Exchange Act of 1934.

We have reviewed the reports and written representations from the executive officers and directors. The Corporation believes that all filing requirements were met during 2005.

### CODE OF ETHICS

All our employees, including our Chief Executive Officer, Chief Financial Officer and Principal Accounting Officer are required to abide by our Code of Ethics to ensure that our business is conducted in a consistently legal and ethical manner. This Code of Ethics forms the foundation of a comprehensive process that includes compliance with all corporate policies and procedures, an



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open relationship among colleagues that contributes to good business conduct, and an abiding belief in the integrity of our employees. Our policies and procedures cover all areas of professional conduct, including employment policies, conflicts of interest, intellectual property and the protection of confidential information, as well as strict adherence to all laws and regulations applicable to the conduct of our business.

Employees are required to report any conduct they believe in good faith to be an actual or apparent violation of the standards contained in our Code of Ethics or any other unusual or suspicious business arrangement or behavior. The Sarbanes-Oxley Act of 2002 requires audit committees to have procedures to receive, retain and treat complaints received regarding accounting, internal accounting controls or auditing matters and to allow for the confidential and anonymous submission by employees of concerns regarding questionable accounting or auditing matters. We currently have such procedures in place.

In addition, the members of our Board of Directors are required to comply with the Code of Ethics. This Code of Ethics is intended to focus the Board and the individual directors on areas of ethical risk, help directors recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and foster a culture of honesty and accountability. The Code of Ethics covers all areas of professional conduct relating to service on the Board, including conflicts of interest, unfair or unethical use of corporate opportunities, strict maintenance of confidential information, compliance with all applicable laws and regulations and oversight of ethics and compliance by employees of the Company.

Copies of our Code of Ethics will be provided without charge upon written request to: Virginia D. Kocher, Treasurer, 232 East Street, Bloomsburg, PA 17815. This Code of Ethics is also included in this 10K as Exhibit 14.

### ITEM 11. EXECUTIVE COMPENSATION

This section of the report contains a table that shows the amounts of compensation earned by our executive officers whose salary and bonus exceeded \$100,000 for 2005. The bank makes all payments to the applicable executive officers. This section also contains the performance graph comparing our performance relative to a peer group and the report of our compensation committee on executive compensation explaining compensation philosophy for our most highly paid officers.

#### SUMMARY COMPENSATION TABLE

| NAME AND PRINCIPAL POSITION           | FISCAL YEAR | ANNUAL COMPENSATION (1) |            |                                | ALL OTHER COMPENSATION (\$) |
|---------------------------------------|-------------|-------------------------|------------|--------------------------------|-----------------------------|
|                                       |             | SALARY (\$)             | BONUS (\$) | OTHER ANNUAL COMPENSATION (\$) |                             |
| LANCE O. DIEHL                        | 2005        | 120,000                 | 3,870 (2)  | 16,422 (3)                     | 22,379 (4)                  |
| PRESIDENT AND CHIEF EXECUTIVE OFFICER | 2004        | 110,000                 | 3,517 (5)  | 15,391 (6)                     | 20,477 (7)                  |
|                                       | 2003        | 100,000                 | 1,883 (8)  | 13,048 (9)                     | 15,474 (10)                 |
| EDWIN A. WENNER                       | 2005        | 104,000                 | 3,325 (2)  | 4,293 (11)                     | 51,418 (12)                 |
| EXECUTIVE VICE PRESIDENT              | 2004        | 95,000                  | 2,975 (5)  | 3,919 (13)                     | 47,873 (14)                 |
| AND CHIEF OPERATING OFFICER           | 2003        | 85,000                  | 1,843 (8)  | 3,474 (15)                     | 36,767 (16)                 |

(1) From January 1, 2003 through December 31, 2005, we did not pay any long-term compensation in the form of stock options, stock appreciation rights, restricted stock or any other long-term compensation, nor did we

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enter into any long-term incentive plan payments. Accordingly, no such information is presented in the summary compensation table set forth above. No such arrangements are currently in effect.

- (2) Represents a cash bonus representing 3 1/2% of 2004 base salary.
- (3) Includes \$11,400 as the payment of directors' fees and \$5,022 representing the year 2005, 100% up to 3% and 50% up to the next 2% matching contribution to Mr. Diehl's 401K plan.
- (4) Includes \$19,405 as a payment for a deferred compensation plan; \$949 representing car expense; \$258 representing cell phone expense; \$826 representing cafeteria plan benefits, \$266 as annual term insurance premium payments on the life of Mr.

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Diehl, \$600 representing 1/3 partial corporate membership in the Berwick Golf Club and \$75 representing Years of Service Award for ten years of employment at CCFNB.

- (5) Represents a cash bonus representing 3 1/2% of 2003 base salary.
- (6) Includes \$10,800 as the payment of directors' fees and \$4,591 representing the year 2004, 100% up to 3% and 50% up to the next 2% matching contribution to Mr. Diehl's 401K plan.
- (7) Includes \$16,047 as a payment for a deferred compensation plan; \$678 representing car expense; \$403 representing cell phone expense; \$758 representing cafeteria plan benefits, \$2,356 representing a Berwick Golf Club membership and \$235 as annual term insurance premium payments on the life of Mr. Diehl.
- (8) Represents a cash bonus representing 2 1/2% of 2002 base salary.
- (9) Includes \$8,925 as the payment of directors' fees and \$4,123 representing the year 2003, 100% up to 3% and 50% up to the next 2% matching contribution to Mr. Diehl's 401K plan.
- (10) Includes \$11,099 as a payment for a deferred compensation plan; \$711 representing car expense; \$420 representing cell phone expense; \$661 representing cafeteria plan benefits, \$2,356 representing a Berwick Golf Club membership and \$227 as annual term insurance premium payments on the life of Mr. Diehl.
- (11) Represents the year 2005, 100% up to 3% and 50% up to the next 2% matching contribution to Mr. Wenner's 401K plan.
- (12) Includes \$40,578 as a payment for a deferred compensation plan; \$259 representing cell phone expense; \$7,511 representing cafeteria plan benefits, \$600 representing 1/3 partial corporate membership in the Berwick Golf Club and \$2,470 as annual term insurance premium payments on the life of Mr. Wenner.
- (13) Represents the year 2004, 100% up to 3% and 50% up to the next 2% matching contribution to Mr. Wenner's 401K plan.
- (14) Includes \$35,174 as a payment for a deferred compensation plan; \$408 representing cell phone expense; \$8,008 representing cafeteria plan

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benefits, \$2,356 representing a Berwick Golf Club membership and \$1,927 as annual term insurance premium payments on the life of Mr. Wenner.

- (15) Represents the year 2003, 100% up to 3% and 50% up to the next 2% matching contribution to Mr. Wenner's 401K plan.
- (16) Includes \$24,328 as a payment for a deferred compensation plan; \$420 representing cell phone expense, \$8,410 representing cafeteria plan benefits, \$2,356 representing a Berwick Golf Club membership and \$1,253 as annual term insurance premium payments on the life of Mr. Wenner.

### COMMITTEE REPORT ON EXECUTIVE COMPENSATION (HOW WE DETERMINE EXECUTIVE COMPENSATION)

#### COMPOSITION OF COMMITTEE

All of our independent directors deem executive compensation to be very important to the overall development and performance of the company, so they decided to sit as our committee on executive compensation. Mr. Diehl, the President and Chief Executive Officer, and Mr. Reichart, the Chairman, do not participate in discussions and decisions concerning their performance and compensation. All of our other directors meet the independence standards contained in Rule 4200(a)(15) of the listing rules for The NASDAQ Stock Market.

In addition to this committee on executive compensation, the bank has a Human Resource Committee comprised of four of our directors who also serve as directors of the bank. One of those directors is Mr. Reichart who is also the Chairman of the bank. The bank's Human Resource Committee discusses and reviews evaluations of all management positions within the bank, except for Messrs Reichart, the Chairman, Diehl, the President and Chief Executive Officer, and Wenner, the Executive Vice President and Chief Operating Officer. The compensation committee on executive compensation is solely responsible for the compensation decisions involving the latter three officers.

#### Objectives Of Executive Compensation

Our executive compensation policy aims to:

- Link the executive's goals with your interests as stockholders;
- Support our strategic business plan and long-term development;
- Tie a portion of the executive's compensation to our overall performance; and
- Attract and retain talented management.

#### Type Of Compensation

We utilize annual compensation which includes salary, bonus and contributions to our 401K profit sharing plan. We award bonuses based upon our and the specific executive's performance as a whole and may award bonuses based on the specific executive's performance.

We do not have a long-term compensation program based upon the award of stock options and restricted stock or other long-term incentive awards. However, we do

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have long-term compensation agreements. See the discussion of these agreements elsewhere in this 10K. We may consider the award of stock options in the future.

### Factors Considered In Determining Compensation

Our committee on executive compensation wants the compensation of an executive to be competitive with other commercial banking institutions doing business in similar markets. Each year, our compensation committee on executive compensation and the bank's Human Resources Committee reviews a report from an outside consultant that delineates compensation at peer group banking companies; discusses such report as well as the performance and compatibility to the position with each executive; and takes into consideration recommendations by such executives supervisory officers or by members of the Board of Directors for the senior most executives. The total executive compensation for Mr. Diehl places his compensation below the average of the lowest percentile and for Mr. Wenner above the average of the median percentile, of bank executives in peer group companies based upon the report of the consultant. Mr. Reichart's compensation is based upon his lifelong experience in the banking industry as well as a survey of the compensation afforded to chairmen of local banking organizations in our Market Area. All of these factors are taken into consideration in the determination of the compensation of the executives as a group and of the officers individually.

### Annual Compensation

Annual compensation for our senior executives includes salary, any bonus and contribution to his 401K profit sharing plan. This is similar to the compensation programs for most of our peer group banking companies.

### Chief Executive Officer Compensation

Mr. Diehl received total compensation of \$162,671 in the year 2005. Please refer to the Summary Compensation Table for more details.

We established the following 2006 compensation package for Mr. Diehl: Annual salary to be paid is \$135,000 and we expect the other payment and benefits described in the Summary Compensation Table to remain comparable in 2006 as in 2005. The Deferred Compensation amount is expected to increase approximately \$731 in 2006.

### Chief Operating Officer Compensation

Mr. Wenner received total compensation of \$163,036 in the year 2005. Please refer to the Summary Compensation Table for more details.

We established the following 2006 compensation package for Mr. Wenner: Annual salary to be paid is \$115,000, and we expect the other payment and benefits described in the Summary Compensation Table to remain comparable in 2006 as in 2005. The Deferred Compensation amount is expected to increase approximately \$2,400 in 2006.

### Other Factors That Influenced Compensation

Our Compensation Committee considered that Mr. Diehl has worked for the bank for a total of 12 years and has 18 years experience in the financial services industry. Mr. Diehl is a magna cum laude graduate of Bloomsburg University, receiving a Bachelor of Science in Business Administration; holds a Masters in Business Administration from Lehigh University; and is a graduate of the Stonier Graduate School of Banking.

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Mr. Wenner has been employed at CCFNB since May 1974. During this time, he has held duties as Teller, Technology Director, Internal Auditor, Loan Officer, Community Office Manager, Credit Administrator, Vice President, Senior Vice President and his present position of Executive Vice President and Chief Operating Officer. In his present capacity, Mr. Wenner has direct supervision over areas which include accounting, data deposit operations, information technology, human resources, training, compliance, security, credit administration and branch administration.

### Committee on Executive Compensation

Robert M. Brewington, Jr.  
Edward L. Campbell  
Frank D. Gehrig  
Elwood R. Harding, Jr.  
William F. Hess  
Willard H. Kile, Jr.  
Charles E. Long

### Deferred Compensation Agreements for Executive Officers

In 1992, the Bank entered into agreements with two executive officers, Paul E. Reichart and J. Jan Girton, to establish non-qualified deferred compensation plans. Each officer deferred compensation in order to participate in this Deferred Compensation Plan. If the officer continued to serve as an officer of the Bank until he attained 65 years of age, the Bank agreed to pay him 120 consecutive monthly payments commencing on the first day of the month following that officer's 65th birthday. Each officer's monthly payment is based upon the future value of life insurance purchased with the compensation the officer has deferred. The Bank has obtained life insurance (designating the bank as the beneficiary) on the life of each of these officers in an amount which is intended to cover the bank's obligations under this Deferred Compensation Plan, based upon certain actuarial assumptions.

During 2002, these agreements with the two executive officers, Paul E. Reichart and J. Jan Girton, were modified. Mr. Reichart will receive monthly payments of \$1,875 for 120 consecutive months commencing in February 2003, and Mr. Girton will receive monthly payments of \$1,458.33 for 120 consecutive months commencing in April 2003. Mr. Girton's agreement will also provide post employment health care benefits to him until the attainment of age 65. As of December 31, 2005 and 2004, the net cash values of insurance policies were \$370,986 and \$344,936, respectively. The total accrued liability, equal to the present value of these obligations, was \$241,772 and \$269,418, respectively. The accrued liability related to the post employment health care benefit was \$1,451 and \$9,024 as of December 31, 2005 and 2004, respectively. Mr. Reichart is the former President and Chief Executive Officer of the bank and currently the Chairman of the Board. Mr. Girton served in the capacity of Chief Operating Officer and Executive Vice President and retired in 2003.

In April 2003, the bank entered into non-qualified deferred compensation agreements with three additional officers, Lance O. Diehl, Edwin A. Wenner and Jacob S. Trump, to provide supplemental retirement benefits commencing with these executive's retirement and ending 15 years thereafter. The deferred compensation expense related to these agreements for the year ended December 31, 2005 was \$91,507 and the total accrued liability as of December 31, 2005 and December 31, 2004 was \$226,348 and \$134,841, respectively. Mr. Diehl is currently the President and Chief Executive Officer. Mr. Wenner is currently the Executive Vice President and Chief Operating Officer. Mr. Trump is currently the Senior Vice President of Financial Planning.

FIVE-YEAR PERFORMANCE GRAPH

The following graph and table compare the cumulative total stockholder return on our Common Stock during the five-year period ending on December 31, 2005, with the cumulative total return on the SNL Securities Corporate Performance Index (1) for 35 publicly-traded banks with under \$250 million in total assets in the United States of America, and the cumulative total return for all United States stocks traded on the NASDAQ Stock Market. The comparison assumes the value of the investment in our Common Stock and each index was \$100 on December 31, 2000, and assumes further the reinvestment of dividends into the applicable securities. The stockholder return shown on the graph and table below is not necessarily indicative of future performance.

CCFNB BANCORP, INCORPORATED

TOTAL RETURN PERFORMANCE

(PERFORMANCE GRAPH)

| INDEX                       | PERIOD ENDING |          |          |          |          |          |
|-----------------------------|---------------|----------|----------|----------|----------|----------|
|                             | 12/31/00      | 12/31/01 | 12/31/02 | 12/31/03 | 12/31/04 | 12/31/05 |
| CCFNB Bancorp, Incorporated | 100.00        | 143.65   | 153.34   | 185.01   | 182.77   | 197.44   |
| NASDAQ Composite            | 100.00        | 79.18    | 54.44    | 82.09    | 89.59    | 91.54    |
| SNL                         |               |          |          |          |          |          |