CHEMUNG FINANCIAL CORP
Form 10-Q
August 08, 2014

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

FORM 10-Q
[X]
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For Quarterly period ended June 30, 2014
Or
[ ]
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File No. 0-13888

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

New York	16-1237038
(State or other jurisdiction of incorporation or organization)	I.R.S. Employer Identification No.
One Chemung Canal Plaza, P.O. Box 1522, Elmira, NY	14902
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
YES: X NO:____

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ] Smaller reporting company [ ]

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

The number of shares of the registrant's common stock, $.01 par value, outstanding on August 8, 2014 was 4,618,839.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

INDEX

GLOSSARY OF TERMS AND ABBREVIATIONS

To assist the reader the Corporation has provided the following list of commonly used acronyms and abbreviations included in the Notes to the Unaudited Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

BANK	Chemung Canal Trust Company
CDO	Collateralized Debt Obligation
CORPORATION	Chemung Financial Corporation
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FHLBNY	Federal Home Loan Bank New York
FRB	Board of Governors of the Federal Reserve System
FRBNY	Federal Reserve Bank of New York
FREDDIE MAC	Federal Home Loan Mortgage Corporation
GAAP	U.S. generally accepted accounting principles
OTTI	Other-than-temporary impairment
PCI	Purchased credit impaired
SEC	Securities and Exchange Commission
TDRs	Troubled debt restructurings

PART I. FINANCIAL INFORMATION
Item 1: Financial Statements-Unaudited
CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
UNAUDITED

(dollars in thousands, except per share data)	June 30, 2014	December 31, 2013
ASSETS		
Cash and due from financial institutions	$35,981	$31,600
Interest-bearing deposits in other financial institutions	30,301	20,009
Total cash and cash equivalents	66,282	51,609
Trading assets, at fair value	450	366
Securities available for sale, at estimated fair value	286,398	346,016
Securities held to maturity, estimated fair value of $5,632 at June 30, 2014 and $6,930 at December 31,2013	5,274	6,495
Federal Home Loan Bank and Federal Reserve Bank Stock, at cost	4,730	4,482
Loans, net of deferred origination fees and costs, and unearned income	1,084,353	995,866
Allowance for loan losses	(13,632)	(12,776)
Loans, net	1,070,721	983,090
Loans held for sale	914	695
Premises and equipment, net	29,938	30,039
Goodwill	21,824	21,824
Other intangible assets, net	5,708	6,377
Bank owned life insurance	2,725	2,796
Accrued interest receivable and other assets	20,917	22,354
Total assets	$1,515,881	$1,476,143
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	$365,056	$351,222
Interest-bearing	943,372	915,034
Total deposits	1,308,428	1,266,256
Securities sold under agreements to repurchase	30,746	32,701
Federal Home Loan Bank term advances	24,136	25,243
Long term capital lease obligation	384	-
Dividends payable	1,201	1,195
Accrued interest payable and other liabilities	9,205	12,170
Total liabilities	1,374,100	1,337,565
Shareholders' equity:		
Common stock, $.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at June 30, 2014 and December 31, 2013	53	53
Additional-paid-in-capital	45,494	45,399
Retained earnings	112,624	111,031
Treasury stock, at cost (691,237 shares at June 30, 2014; 707,674 shares at December 31, 2013)	(17,640)	(18,060)

Accumulated other comprehensive income	1,250	155
Total shareholders' equity	141,781	138,578
Total liabilities and shareholders' equity	$1,515,881	$1,476,143

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
UNAUDITED

(dollars and share amounts in thousands, except per share data)	Six months ended June 30,		Three months ended June 30,	
	2014	2013	2014	2013
Interest and dividend income:				
Loans, including fees	$22,617	$22,360	$11,449	$11,056
Taxable securities	2,768	2,117	1,264	986
Tax exempt securities	522	586	258	281
Interest-bearing deposits	43	18	25	10
Total interest and dividend income	25,950	25,081	12,996	12,333
Interest Expense				
Deposits	1,040	1,219	517	595
Securities sold under agreements to repurchase	420	431	212	211
Borrowed funds	382	387	192	199
Total interest expense	1,842	2,037	921	1,005
Net interest income	24,108	23,044	12,075	11,328
Provision for loan losses	1,741	881	1,103	451
Net interest income after provision for loan losses	22,367	22,163	10,972	10,877
Other operating income:				
Wealth management group fee income	3,872	3,635	1,989	1,885
Service charges on deposit accounts	2,582	2,155	1,350	1,186
Net gain on securities transactions	522	1	522	1
Net gain on sales of loans held for sale	125	291	83	179
Net (loss) gain on sales of other real estate owned	(44)	16	(14)	16
Income from bank owned life insurance	39	42	19	21
Other	3,274	2,357	1,457	1,187
Total other operating income	10,370	8,497	5,406	4,475
Other operating expense:				
Salaries and wages	10,309	9,417	5,156	4,599
Pension and other employee benefits	2,838	2,789	1,479	1,365
Net occupancy expenses	3,452	2,701	1,659	1,339
Furniture and equipment expenses	1,345	1,086	715	567
Data processing expense	2,895	2,241	1,414	1,128
Professional services	643	525	421	214
Amortization of intangible assets	669	449	324	196
Marketing and advertising expenses	625	485	332	197
Other real estate owned expenses	132	62	45	27
FDIC insurance	543	419	274	203
Loan expense	295	335	146	192
Merger and acquisition related expenses	115	-	29	-
Other	3,062	2,607	1,585	1,364
Total operating expenses	26,923	23,116	13,579	11,391
Income before income tax expense	5,814	7,544	2,799	3,961
Income tax expense	1,820	2,478	869	1,306

Net Income	$3,994	$5,066	$1,930	$2,655
Weighted average shares outstanding	4,679	4,657	4,681	4,658
Basic and diluted earnings per share	$0.85	$1.09	$0.41	$0.57

See accompanying notes to unaudited consolidated financial statements.

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

(dollars in thousands)	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013
Net income	$3,994	$5,066	$1,930	$2,655
Other comprehensive income:				
Unrealized holding gains (losses) on securities available for sale	2,015	(3,305)	1,131	(3,235)
Reclassification adjustment gains realized in net income	(522)	(1)	(522)	(1)
Net unrealized gains (losses)	1,493	(3,306)	609	(3,236)
Tax effect	574	(1,271)	234	(1,244)
Net of tax amount	919	(2,035)	375	(1,992)
Change in funded status of defined benefit pension plan and other benefit plans:				
Net gain (loss) arising during the period	-	-	-	-
Reclassification adjustment for amortization of prior service costs	(44)	(41)	(22)	(21)
Reclassification adjustment for amortization of net actuarial loss	330	801	165	401
Total before tax effect	286	760	143	380
Tax effect	110	293	55	140
Net of tax amount	176	467	88	240
Total other comprehensive income (loss)	1,095	(1,568)	463	(1,752)
Comprehensive income	$5,089	$3,498	$2,393	$903

See accompanying notes to unaudited consolidated financial statements.

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

(dollars in thousands except share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balances at December 31, 2012	$ 53	$ 45,357	$ 107,078	$ (18,566)	$ (2,807)	$ 131,115
Net income	-	-	5,066	-	-	5,066
Other comprehensive income	-	-	-	-	(1,568)	(1,568)
Restricted stock awards	-	86	-	-	-	86
Restricted stock units for directors' deferred compensation plan	-	51	-	-	-	51
Cash dividends declared ($.52 per share)	-	-	(2,389)	-	-	(2,389)
Distribution of 7,969 shares of treasury stock for directors' compensation	-	14	-	203	-	217
Distribution of 4,116 shares of treasury stock for employee compensation	-	7	-	105	-	112
Distribution of 3,356 shares of treasury stock for deferred directors' compensation	-	(75)	-	86	-	11
Purchase of 3,094 shares of treasury stock	-	-	-	(93)	-	(93)
Sale of 2,369 shares of treasury stock	-	11	-	60	-	71
Balances at June 30, 2013	$ 53	$ 45,451	$ 109,755	$ (18,205)	$ (4,375)	$ 132,679
Balances at December 31, 2013	$ 53	$ 45,399	$ 111,031	$ (18,060)	$ 155	$ 138,578
Net income	-	-	3,994	-	-	3,994
Other comprehensive income	-	-	-	-	1,095	1,095
Restricted stock awards	-	74	-	-	-	74
Restricted stock units for directors' deferred compensation plan	-	48	-	-	-	48
Distribution of 990 shares of treasury stock granted for employee restricted stock awards, net	-	(26)	-	26	-	-
Cash dividends declared ($.52 per share)	-	-	(2,401)	-	-	(2,401)
Distribution of 8,385 shares of treasury stock for directors' compensation	-	59	-	214	-	273
Distribution of 3,467 shares of treasury stock for deferred directors' compensation	-	(85)	-	88	-	3
Distribution of 3,595 shares of treasury stock for employee compensation	-	25	-	92	-	117
Balances at June 30, 2014	$ 53	$ 45,494	$ 112,624	$ (17,640)	$ 1,250	$ 141,781

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIESCONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(dollars in thousands)	SIX MONTHS ENDED JUNE 30,	
CASH FLOWS FROM OPERATING ACTIVITIES:	2014	2013
Net income	$3,994	$5,066
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	669	449
Provision for loan losses	1,741	881
Depreciation and amortization of fixed assets	1,808	1,513
Amortization of premiums on securities, net	1,223	1,125
Gains on sales of loans held for sale, net	(125)	(291)
Proceeds from sales of loans held for sale	5,477	9,470
Loans originated and held for sale	(5,571)	(9,069)
Net gains on trading assets	(30)	(13)
Net gains on securities transactions	(522)	(1)
Proceeds from sales of trading assets	7	5
Purchase of trading assets	(61)	(32)
Net loss (gain) on sales of other real estate owned	44	(16)
Decrease (increase) in other assets	1,672	(1,422)
Decrease in prepaid FDIC assessment	-	1,970
Decrease in accrued interest payable	(46)	(48)
Expense related to restricted stock units for directors' deferred compensation plan	48	51
Expense related to employee stock compensation	117	112
Expense related to employee stock awards	74	86
(Decrease) increase in other liabilities	(3,041)	1,289
Proceeds from bank owned life insurance	110	-
Increase in bank owned life insurance	(39)	(42)
Net cash provided by operating activities	7,549	11,083
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and calls of securities available for sale	49,765	10,534
Proceeds from maturities and principal collected on securities available for sale	13,272	31,120
Proceeds from maturities and principal collected on securities held to maturity	1,813	3,908
Purchases of securities available for sale	(2,627)	(31,760)
Purchases of securities held to maturity	(592)	(4,730)
Purchase of FHLB and FRBNY stock	(293)	(2,930)
Redemption of FHLB and FRBNY stock	45	3,061
Purchases of premises and equipment	(1,707)	(998)
Proceeds from sales of other real estate owned	298	88
Net increase in loans	(89,949)	(40,611)
Net cash used by investing activities	(29,975)	(32,318)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits, interest-bearing demand accounts, savings accounts, and insured money market accounts	61,148	21,959
Net decrease in time deposits	(18,976)	(11,725)
Net decrease in securities sold under agreements to repurchase	(1,955)	(2,143)
Repayments of FHLB long term advances	(1,107)	(1,124)
Increase in long term capital lease obligation	384	-
Purchase of treasury stock	-	(93)

Sale of treasury stock	-	71
Cash dividends paid	(2,395)	(1,194)
Net cash provided by financing activities	37,099	5,751
Net increase (decrease) in cash and cash equivalents	14,673	(15,484)
Cash and cash equivalents, beginning of period	51,609	40,241
Cash and cash equivalents, end of period	$66,282	$24,757

Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest	$1,888	$2,085
Income taxes	$1,246	$2,591
Supplemental disclosure of non-cash activity:		
Transfer of loans to other real estate owned	$578	$95
Dividends declared, not yet paid	$1,201	$1,195

See accompanying notes to unaudited consolidated financial statements.

8

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Corporation, through its wholly owned subsidiaries, the Bank and CFS Group, Inc., provides a wide range of banking, financing, fiduciary and other financial services to its clients. The Corporation and the Bank are subject to the regulations of certain federal and state agencies and undergo periodic examinations by those regulatory authorities.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with GAAP and include the accounts of the Corporation and its subsidiaries. All significant intercompany balances and transactions are eliminated in consolidation. Amounts in the prior periods' consolidated financial statements are reclassified whenever necessary to conform with the current period's presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. The allowance for loan losses, fair value of financial instruments, other-than-temporary impairment of investment securities and goodwill and other intangibles are particularly subject to change.

Subsequent Events

The Corporation has evaluated events and transactions through the time the unaudited consolidated financial statements were issued. Financial statements are considered issued when they are widely distributed to all shareholders and other financial statement users, or filed with the SEC. In conjunction with applicable accounting standards, all material subsequent events have been either recognized in the unaudited consolidated financial statements or disclosed in the notes to the unaudited consolidated financial statements.

Recent Accounting Pronouncements

In January, 2014 the FASB issued ASU-2014-04, an amendment to Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40), Reclassification of Residential Real Estate and Collateralized Consumer Mortgage Loans upon Foreclosure. The objective of this ASU is to improve reporting by clarifying when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable is derecognized and the real estate property recognized. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Corporation will adopt all provisions of this ASU as of January 1, 2015. We are currently evaluating the potential impact on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, an amendment to Revenue from Contracts with Customers (Topic 606). The objective of the ASU is to align the recognition of revenue with the transfer of promised goods or services provided to customers in an amount that reflects the consideration which the entity expects to be entitled in exchange for those goods or services. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2016. The Corporation will adopt all provisions of this ASU as of January 1, 2017. We are currently evaluating the potential impact on our consolidated financial statements.

In June 2014 the FASB issued ASU 2014-11, an amendment to Transfers and Servicing (Topic 860): Repurchase-to Maturity Transactions, Repurchase Financings, and Disclosures. The objective of this ASU is to improve consistency in reporting repurchase transactions as secured borrowings and providing additional information of the collateral pledged. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Corporation will adopt all provisions of this ASU as of January 1, 2015. We are currently evaluating the potential impact on our consolidated financial statements.

NOTE 2 EARNING PER COMMON SHARE (shares in thousands)

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors' restricted stock units and directors' stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities and are considered outstanding at grant date. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,679 and 4,657 weighted average shares outstanding for the six-month periods ended June 30, 2014 and 2013, respectively. Earnings per share were computed by dividing net income by 4,681 and 4,658 weighted average shares outstanding for the three-month periods ended June 30, 2014 and 2013, respectively. There were no dilutive common stock equivalents during the three or six-month periods ended June 30, 2014 or 2013.

NOTE 3 SECURITIES

Amortized cost and estimated fair value of securities available for sale are as follows (dollars in thousands):

	June 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	$166,253	$ 1,789	$ 96	$167,946
Mortgage-backed securities, residential	66,933	1,007	16	67,924
Collateralized mortgage obligations	606	8	-	614
Obligations of states and political subdivisions	34,958	1,016	27	35,947
Corporate bonds and notes	2,610	50	5	2,655
SBA loan pools	1,383	16	1	1,398
Trust Preferred securities	1,902	132	-	2,034
Corporate stocks	443	7,439	2	7,880
Total	$275,088	$ 11,457	$ 147	$286,398

	December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	$187,098	$ 1,915	$ 907	$188,106
Mortgage-backed securities, residential	104,069	1,036	749	104,356
Collateralized mortgage obligations	1,001	14	-	1,015
Obligations of states and political subdivisions	37,339	1,059	22	38,376
Corporate bonds and notes	2,879	76	9	2,946
SBA loan pools	1,471	17	-	1,488
Trust preferred securities	1,898	136	-	2,034
Corporate stocks	444	7,253	2	7,695
Total	$336,199	$ 11,506	$ 1,689	$346,016

Amortized cost and estimated fair value of securities held to maturity are as follows (dollars in thousands):

	June 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	$4,503	$ 355	$ -	$ 4,858
Time deposits with other financial institutions	771	3	-	774
Total	$5,274	$ 358	$ -	$ 5,632

	December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	$5,472	$ 419	$ -	$ 5,891
Time deposits with other financial institutions	1,023	16	-	1,039
Total	$6,495	$ 435	$ -	$ 6,930

The amortized cost and estimated fair value of debt securities are shown below by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately (dollars in thousands):

	June 30, 2014			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within One Year	$27,621	$27,954	$1,903	$1,921
After One, But Within Five Years	171,537	173,982	2,219	2,390
After Five, But Within Ten Years	6,565	6,646	1,152	1,321
After Ten Years	-	-	-	-
	205,723	208,582	5,274	5,632
Mortgage-backed securities, residential	66,933	67,924		
Collateralized mortgage obligations	606	614		
SBA loan pools	1,383	1,398		
Total	$274,645	$278,518	$5,274	$5,632

The proceeds from sales and calls of securities resulting in gains or losses at June 30, 2014 and June 30, 2013 are listed below (dollars in thousands):

	2014	2013
Proceeds	$49,765	$10,534
Gross gains	$522	$1
Gross losses	$-	$-
Tax expense	$201	$-

The following tables summarize the investment securities available for sale with unrealized losses at June 30, 2014 and December 31, 2013 by aggregated major security type and length of time in a continuous unrealized loss position (dollars in thousands):

	Less than 12 months		12 months or longer		Total	
June 30, 2014	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government and U.S. Government sponsored enterprises	$19,800	$ 21	$15,728	$ 75	$35,528	$ 96
Mortgage-backed securities, residential	5,587	16		-	5,587	16
Obligations of states and political subdivisions	4,440	24	737	3	5,177	27
Corporate bonds and notes	-	-	242	5	242	5
SBA loan pools	620	1	-	-	620	1
Corporate stocks	-	-	2	2	2	2
Total temporarily impaired securities	$30,447	$ 62	$16,709	$ 85	$47,156	$ 147

	Less than 12 months		12 months or longer		Total	
December 31, 2013		Unrealized		Unrealized		Unrealized

	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
Obligations of U.S. Government and U.S. Government sponsored enterprises	$83,840	$ 867	$1,978	$ 39	$85,818	$ 906
Mortgage-backed securities, residential	63,115	750	-	-	63,115	750
Obligations of states and political subdivisions	4,589	22	-	-	4,589	22
Corporate bonds and notes	238	9	-	-	238	9
Corporate stocks	-	-	2	2	2	2
Total temporarily impaired securities	$151,782	$ 1,648	$1,980	$ 41	$153,762	$ 1,689

11

Other-Than-Temporary Impairment

As of June 30, 2014, the majority of the Corporation's unrealized losses in the investment securities portfolio related to obligations of U.S. Government and U.S. Government sponsored enterprises and mortgage-backed securities. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Corporation does not have the intent to sell these securities and it is not likely that it will be required to sell these securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at June 30, 2014.

During the first quarter of 2014, the Corporation received notice that one CDO consisting of a pool of trust preferred securities was liquidated and recorded $0.5 million in other operating income during the first quarter of 2014. The Corporation does not own any other CDO's in its investment securities portfolio.

The tables below present a roll forward of the cumulative credit losses recognized in earnings for the three and six-month periods ending June 30, 2014 and 2013 (dollars in thousands):

	2014	2013
Beginning balance, January 1,	$1,939	$3,506
Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized	-	-
Additions/Subtractions:		
Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-
Reductions for previous credit losses realized in securities liquidated during the period	(1,939)	-
Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	-	-
Ending balance, June 30,	$-	$3,506

	2014	2013
Beginning balance, April 1,	$ -	$3,506
Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized	-	-
Additions/Subtractions:		
Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-
Reductions for previous credit losses realized in securities liquidated during the period	-	-
Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	-	-
Ending balance, June 30,	$ -	$3,506

NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio, net of deferred origination fees and cost, and unearned income is summarized as follows (dollars in thousands):

	June 30, 2014	December 31, 2013
Commercial and agricultural:		
Commercial and industrial	$158,151	$144,787
Agricultural	726	576
Commercial mortgages:		
Construction	39,106	27,440
Commercial mortgages	383,187	345,707
Residential mortgages	194,603	195,997
Consumer loans:		
Credit cards	1,604	1,756
Home equity lines and loans	99,023	95,905
Indirect consumer loans	187,082	164,846
Direct consumer loans	20,871	18,852
Total loans, net of deferred origination fees and costs, and unearned income	$1,084,353	$995,866
Interest receivable on loans	2,402	2,597
Total recorded investment in loans	$1,086,755	$998,463

The Corporation's concentrations of credit risk by loan type are reflected in the preceding table. The concentrations of credit risk with standby letters of credit, committed lines of credit and commitments to originate new loans generally follow the loan classifications in the table above.

The following tables present the activity in the allowance for loan losses by portfolio segment for the three and six-month periods ending June 30, 2014 and 2013 (dollars in thousands):

	Six Months Ended June 30, 2014					
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	$1,979	$ 6,243	$ 1,517	$ 3,037	$ -	$12,776
Charge Offs:	(355)	(358)	(7)	(776)	-	(1,496)
Recoveries:	193	83	28	307	-	611
Net recoveries (charge offs)	(162)	(275)	21	(469)	-	(885)
Provision	(68)	944	(40)	905	-	1,741
Ending balance	$1,749	$ 6,912	$ 1,498	$ 3,473	$ -	$13,632

	Six Months Ended June 30, 2013					
Allowance for loan losses	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total

Beginning balance:	$1,708	$ 4,428	$ 1,565	$ 2,706	$ 26	$10,433
Charge Offs:	(18)	-	(54)	(398)	-	(470)
Recoveries:	294	19	39	124	-	476
Net recoveries (charge offs)	276	19	(15)	(274)	-	6
Provision	(105)	687	(35)	360	(26)	881
Ending balance	$1,879	$ 5,134	$ 1,515	$ 2,792	$ -	$11,320

13

Allowance for loan losses	Three Months Ended June 30, 2014 Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	$1,945	$ 6,484	$ 1,552	$ 3,174	$ -	$13,155
Charge Offs:	(300)	(315)	-	(308)	-	(923)
Recoveries:	100	45	28	124	-	297
Net recoveries (charge offs)	(200)	(270)	28	(184)	-	(626)
Provision	4	698	(82)	483	-	1,103
Ending balance	$1,749	$ 6,912	$ 1,498	$ 3,473	$ -	$13,632

Allowance for loan losses	Three Months Ended June 30, 2013 Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Beginning balance:	$1,993	$ 4,673	$ 1,557	$ 2,602	$ -	$10,825
Charge Offs:	(1)	-	(10)	(201)	-	(212)
Recoveries:	152	10	39	56	-	257
Net recoveries (charge-offs)	151	10	29	(145)	-	45
Provision	(265)	451	(71)	335	-	450
Ending balance	$1,879	$ 5,134	$ 1,515	$ 2,792	$ -	$11,320

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2014 and December 31, 2013 (dollars in thousands):

Allowance for loan losses	June 30, 2014 Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Ending allowance balance attributable to loans:						
Individually evaluated for Impairment	$132	$ 201	$ -	$ 2	$ -	$335
Collectively evaluated for Impairment	1,617	5,244	1,486	3,471	-	11,818
Loans acquired with deteriorated credit quality	-	1,467	12	-	-	1,479
Total ending allowance balance	$1,749	$ 6,912	$ 1,498	$ 3,473	$ -	$13,632

Allowance for loan losses	December 31, 2013 Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
Ending allowance balance						

attributable to loans:						
Individually evaluated for impairment	$576	$ 466	$ -	$ 4	$ -	$1,046
Collectively evaluated for impairment	1,403	4,407	1,497	3,033	-	10,340
Loans acquired with deteriorated credit quality	-	1,370	20	-	-	1,390
Total ending allowance balance	$1,979	$ 6,243	$ 1,517	$ 3,037	$ -	$12,776

14

Loans:	June 30, 2014 Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Loans individually evaluated for impairment	$1,589	$ 9,655	$ 111	$126	$11,481
Loans collectively evaluated for impairment	156,987	405,519	194,727	309,143	1,066,376
Loans acquired with deteriorated credit quality	631	7,997	270	-	8,898
Total ending loans balance	$159,207	$ 423,171	$ 195,108	$309,269	$1,086,755

Loans:	December 31, 2013 Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Loans individually evaluated for impairment	$2,946	$ 10,703	$ 117	$131	$13,897
Loans collectively evaluated for impairment	142,108	354,636	196,147	281,979	974,870
Loans acquired with deteriorated credit quality	678	8,757	261	-	9,696
Total ending loans balance	$145,732	$ 374,096	$ 196,525	$282,110	$998,463

The following tables present loans individually evaluated for impairment recognized by class of loans as of June 30, 2014 and December 31, 2013, the average recorded investment and interest income recognized by class of loans as of the three and six-month periods ended June 30, 2014 and 2013 (dollars in thousands):

	June 30, 2014			December 31, 2013		
With no related allowance recorded:	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
Commercial and agricultural:						
Commercial and industrial	$1,364	$ 1,369	$ -	$1,906	$ 1,909	$ -
Commercial mortgages:						
Construction	1,944	1,929	-	2,329	2,319	-
Commercial mortgages	6,599	6,487	-	7,406	7,439	-
Residential mortgages	111	111	-	117	117	-
Consumer loans:						
Home equity lines and loans	68	70	-	71	73	-
With an allowance recorded:						
Commercial and agricultural:						
Commercial and industrial	520	220	132	1,037	1,037	576
Commercial mortgages:						
Commercial mortgages	1,245	1,239	201	951	945	466
Consumer loans:						
Home equity lines and loans	56	56	2	58	58	4
Total	$11,907	$ 11,481	$ 335	$13,875	$ 13,897	$ 1,046

	Six-Months Ended June 30, 2014		Six-Months Ended June 30, 2013		Three Months Ended June 30, 2014		Three Months Ended June 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:								
Commercial and agricultural:								
Commercial and industrial	$1,566	$ 30	$1,524	$ 35	$1,386	$ 16	$1,554	$ 17
Commercial mortgages:								
Construction	2,231	51	4,168	64	2,101	25	3,669	32
Commercial mortgages	6,806	129	5,685	118	6,489	66	5,983	66
Residential mortgages	114	-	129	-	112	-	127	-
Consumer loans:								
Home equity lines and loans	72	1	30	1	71	1	45	1
With an allowance recorded:								
Commercial and agricultural:								
Commercial and industrial	784	-	499	-	512	-	526	-
Commercial mortgages:								
Commercial mortgages	912	-	614	-	1,010	-	740	-
Consumer loans:								
Consumer loans:								
Home equity lines and loans	58	2	39	1	57	1	58	1
Direct consumer loans	-	-	5	-	-	-	7	-
Total	$12,543	$ 213	$12,693	$ 219	$11,738	$ 109	$12,709	$ 117

Cash basis interest income approximates interest income recognized.

17

The following tables present the recorded investment in past due and non-accrual status by class of loans as of June 30, 2014 and December 31, 2013 (dollars in thousands):

June 30, 2014	Current	30-89 Days Past Due	90 Days or more Past Due and accruing	Loans acquired with deteriorated credit quality	Non-Accrual (1)	Total
Commercial and agricultural:						
Commercial and industrial	$156,888	$468	$ -	$ 631	$ 493	$158,480
Agricultural	727	-	-	-	-	727
Commercial mortgages:						
Construction	35,496	1,313	1,449	774	155	39,187
Commercial mortgages	373,640	262	-	7,223	2,859	383,984
Residential mortgages	189,337	2,113	-	270	3,388	195,108
Consumer loans:						
Credit cards	1,583	14	7	-	-	1,604
Home equity lines and loans	98,029	725	-	-	506	99,260
Indirect consumer loans	185,732	1,439	-	-	300	187,471
Direct consumer loans	20,833	90	-	-	11	20,934
Total	$1,062,265	$6,424	$ 1,456	$ 8,898	$ 7,712	$1,086,755

(1) Includes all loans on non-accrual status regardless of the number of days such loans were delinquent as of June 30, 2014.

December 31, 2013	Current	30-89 Days Past Due	90 Days or more Past Due and accruing	Loans acquired with deteriorated credit quality	Non-Accrual (1)	Total
Commercial and agricultural:						
Commercial and industrial	$143,100	$29	$ -	$ 678	$ 1,348	$145,155
Agricultural	577	-	-	-	-	577
Commercial mortgages:						
Construction	24,742	-	1,454	774	540	27,510
Commercial mortgages	335,123	1,138	-	7,983	2,342	346,586
Residential mortgages	187,448	5,458	-	261	3,358	196,525
Consumer loans:						
Credit cards	1,729	9	19	-	-	1,757
Home equity lines and loans	95,349	150	-	-	635	96,134
Indirect consumer loans	163,810	1,235	-	-	249	165,294
Direct consumer loans	18,830	50	-	-	45	18,925
Total	$970,708	$8,069	$ 1,473	$ 9,696	$ 8,517	$998,463

(1) Includes all loans on non-accrual status regardless of the number of days such loans were delinquent as of December 31, 2013.

18

Troubled Debt Restructurings:

As of June 30, 2014 and December 31, 2013, the Corporation has a recorded investment in troubled debt restructurings of $7.1 million and $7.9 million, respectively. There were specific reserves of less than $0.1 million and $0.3 million allocated for troubled debt restructurings at June 30, 2014 and December 31, 2013, respectively. As of June 30, 2014, troubled debt restructurings totaling $6.4 million were accruing interest under the modified terms and $0.7 million were on non-accrual status. As of December 31, 2013, troubled debt restructurings totaling $6.8 million were accruing interest under the modified terms and $1.1 million were on non-accrual status. The Corporation has committed to lend additional amounts totaling up to less than $0.1 million and $0.2 million as of June 30, 2014 and December 31, 2013, respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

During the six months ended June 30, 2014 and 2013, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: reduced scheduled payments for greater than three months or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

The following table presents loans by class modified as troubled debt restructurings that occurred during the six months ended June 30, 2014 and June 30, 2013 (dollars in thousands):

Six months ended June 30, 2014	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial and industrial	1	$ 503	$ 503
Commercial mortgages:			
Commercial mortgages	2	367	323
Total	3	$ 870	$ 826

Six months ended une 30, 2013	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial and industrial	4	$ 841	$ 841
Commercial mortgages:			
Commercial mortgages	1	133	133
Consumer loans:			
Home equity lines and loans	2	104	104
Total	7	$ 1,078	$ 1,078

The troubled debt restructurings described above did not increase the allowance for loan losses and resulted in less than $0.1 million in charge offs during the six months ended June 30, 2014. The troubled debt restructurings described above increased the allowance for loan losses by less than $0.1 million and resulted in no charge offs during the six months ended June 30, 2013.

There were no payment defaults on any loans previously modified as troubled debt restructurings during the six months ending June 30, 2014 or June 30, 2013, within twelve months following the modification. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

There were no loans modified as troubled debt restructurings during the three months ended June 30, 2014.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three months ended June 30, 2013 (dollars in thousands):

Three months ended June 30, 2013	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial and industrial	2	$ 410	$ 410
Commercial mortgages:			
Commercial mortgages	1	133	133
Total	3	$ 543	$ 543

The troubled debt restructurings described above increased the allowance for loan losses by $0.1 million and resulted in no charge offs during the three months ended June 30, 2013.

There were no payment defaults on any loans previously modified as troubled debt restructurings during the three months ending June 30, 2014 or June 30, 2013, within twelve months following the modification. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

Credit Quality Indicators

The Corporation establishes a risk rating at origination for all commercial loans. The main factors considered in assigning risk ratings include, but are not limited to: historic and future debt service coverage, collateral position, operating performance, liquidity, leverage, payment history, management ability, and the customer's industry. Commercial relationship managers monitor all loans in their respective portfolios for any changes in the borrower's ability to service their debt and affirm the risk ratings for the loans at least annually.

For the retail loans, which include residential mortgages, indirect and direct consumer loans, home equity lines and loans, and credit cards, once a loan is properly approved and closed, the Corporation evaluates credit quality based upon loan repayment.

The Corporation uses the risk rating system to identify criticized and classified loans. Commercial relationships within the criticized and classified risk ratings are analyzed quarterly. The Corporation uses the following definitions for criticized and classified loans (which are consistent with regulatory guidelines):

Special Mention – Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution's credit position at some future date.

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

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

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are included in groups of homogeneous loans. Based on the analyses performed as of June 30, 2014 and December 31, 2013, the risk category of the recorded investment of loans by class of loans is as follows (dollars in thousands):

	June 30, 2014					
	Not Rated	Pass	Loans acquired with deteriorated credit quality	Special Mention	Substandard	Doubtful
Commercial and agricultural:						
Commercial and industrial	$ -	$ 146,698	$ 631	$ 7,775	$ 3,156	$ 220
Agricultural	-	727	-	-	-	-
Commercial mortgages:						
Construction	-	34,885	774	3,373	155	-
Commercial mortgages	-	350,244	7,223	14,159	12,184	174
Residential mortgages	191,368	-	270	-	3,470	-
Consumer loans:						
Credit cards	1,604	-	-	-	-	-
Home equity lines and loans	98,678	-	-	-	582	-
Indirect consumer loans	187,161	-	-	-	310	-
Direct consumer loans	20,922	-	-	-	12	-
Total	$ 499,733	$ 532,554	$ 8,898	$ 25,307	$ 19,869	$ 394

	December 31, 2013					
	Not Rated	Pass	Loans acquired with deteriorated credit quality	Special Mention	Substandard	Doubtful
Commercial and agricultural:						
Commercial and industrial	$ -	$ 133,615	$ 678	$ 5,117	$ 4,724	$ 1,021
Agricultural	-	577	-	-	-	-
Commercial mortgages:						
Construction	-	23,087	774	2,783	866	-
Commercial mortgages	-	313,956	7,983	13,611	11,036	-
Residential mortgages	192,995	-	261	-	3,269	-
Consumer loans						
Credit cards	1,757	-	-	-	-	-
Home equity lines and loans	95,422	-	-	-	712	-
Indirect consumer loans	165,045	-	-	-	249	-
Direct consumer loans	18,880	-	-	-	45	-
Total	$ 474,099	$ 471,235	$ 9,696	$ 21,511	$ 20,901	$ 1,021

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of June 30, 2014 and December 31, 2013 (dollars in thousands):

June 30, 2014					
		Consumer Loans			
	Residential Mortgages	Credit Card	Home Equity Lines and Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	$191,720	$1,604	$98,754	$187,171	$ 20,923
Non-Performing	3,388	-	506	300	11
Total	$195,108	$1,604	$99,260	$187,471	$ 20,934

December 31, 2013					
		Consumer Loans			
	Residential Mortgages	Credit Card	Home Equity Lines and Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	$193,167	$1,757	$95,499	$165,045	$ 18,880
Non-Performing	3,358	-	635	249	45
	$196,525	$1,757	$96,134	$165,294	$ 18,925

At the time of the merger with Fort Orange Financial Corp., the Corporation identified certain loans with evidence of deteriorated credit quality, and the probability that the Corporation would be unable to collect all contractually required payments from the borrower. These loans are classified as PCI loans. The Corporation adjusted its estimates of future expected losses, cash flows, and renewal assumptions on the PCI loans during the current year. These adjustments were made for changes in expected cash flows due to loans refinanced beyond original maturity dates, impairments recognized subsequent to the acquisition, advances made for taxes or insurance to protect collateral held and payments received in excess of amounts originally expected.

The table below summarizes the changes in total contractually required principal and interest cash payments, management's estimate of expected total cash payments and carrying value of the PCI loans from January 1, 2014 to June 30, 2014 and April 1, 2014 to June 30, 2014 (dollars in thousands):

Six months ended June 30, 2014	Balance at December 31, 2013	Income Accretion	All Other Adjustments	Balance at June 30, 2014
Contractually required principal and interest	$ 11,230	$ -	$ (1,173)	$10,057
Contractual cash flows not expected to be collected	(543)	-	57	(486)

(nonaccretable discount)				
Cash flows expected to be collected	10,687	-	(1,116)	9,571
Interest component of expected cash flows (accretable yield)	(991)	344	(26)	(673)
Fair value of loans acquired with deteriorating credit quality	$ 9,696	$ 344	$ (1,142)	$ 8,898

Three months ended June 30, 2014	Balance at March 31, 2014	Income Accretion	All Other Adjustments	Balance at June 30, 2014
Contractually required principal and interest	$ 11,073	$ -	$ (1,016)	$ 10,057
Contractual cash flows not expected to be collected (nonaccretable discount)	(435)	-	(51)	(486)
Cash flows expected to be collected	10,638	-	(1,067)	9,571
Interest component of expected cash flows (accretable yield)	(876)	145	58	(673)
Fair value of loans acquired with deteriorating credit quality	$ 9,762	$ 145	$ (1,009)	$ 8,898

22

NOTE 5 FAIR VALUE

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

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

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

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

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

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

Trading Assets: Securities that are held to fund a deferred compensation plan are recorded at fair value with changes in fair value included in earnings. The fair values of trading assets are determined by quoted market prices (Level 1 inputs).

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

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

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

Assets and liabilities measured at fair value on a recurring basis are summarized below (dollars in thousands):

		Fair Value Measurement at June 30, 2014 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U.S. Government and U.S. Government sponsored enterprises	$167,946	$31,303	$ 136,643	$ -
Mortgage-backed securities, residential	67,924	-	67,924	-
Collateralized mortgage obligations	614	-	614	-
Obligations of states and political subdivisions	35,947	-	35,947	-
Corporate bonds and notes	2,655	-	2,655	-
SBA loan pools	1,398	-	1,398	-
Trust Preferred securities	2,034	-	2,034	-
Corporate stocks	7,880	7,462	418	-
Total available for sale securities	$286,398	$38,765	$ 247,633	$ -
Trading assets	$450	$450	$ -	$ -

		Fair Value Measurement at December 31, 2013 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U.S. Government and U.S. Government sponsored enterprises	$188,106	$31,262	$ 156,844	$ -
Mortgage-backed securities, residential	104,356	-	104,356	-
Collateralized mortgage obligations	1,015	-	1,015	-
Obligations of states and political subdivisions	38,376	-	38,376	-
Corporate bonds and notes	2,946	-	2,946	-
SBA loan pools	1,488	-	1,488	-
Trust Preferred securities	2,034	-	2,034	-
Corporate stocks	7,695	7,279	416	-

Total available for sale securities	$346,016	$38,541	$ 307,475	$ -
Trading assets	$366	$366	$ -	$ -

There were no transfers between Level 1 and Level 2 during the six-month period ending June 30, 2014 or the year ending December, 31, 2013.

Assets and liabilities measured at fair value on a non-recurring basis are summarized below (dollars in thousands):

		Fair Value Measurement at June 30, 2014 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans:				
Commercial and agricultural:				
Commercial and industrial	$ 87	$ -	$ -	$ 87
Commercial mortgages:				
Commercial mortgages	1,044	-	-	1,044
Consumer loans:				