

CHEMUNG FINANCIAL CORP

Form 10-Q

November 13, 2012

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

FORM 10-Q

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

For Quarterly period ended September 30, 2012

Or

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

Commission File No. 0-13888

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

New York 16-1237038
(State or other jurisdiction of I.R.S. Employer Identification No.
incorporation or organization)

One Chemung Canal Plaza, P.O. 14902
Box 1522, Elmira, NY
(Address of principal executive (Zip Code)
offices)

(607) 737-3711 or (800) 836-3711

(Registrant's telephone number, including area code)

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

YES: NO:

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

YES: NO:

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

YES: NO:

The number of shares of the registrant's common stock, \$.01 par value, outstanding on November 12, 2012 was 4,572,875.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1: Financial Statements

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

| | SEPTEMBER 30, 2012 | DECEMBER 31, 2011 |
|---|-----------------------|----------------------|
| ASSETS | | |
| Cash and due from financial institutions | \$ 35,323,663 | \$ 28,204,699 |
| Interest-bearing deposits in other financial institutions | 45,908,073 | 24,697,154 |
| Total cash and cash equivalents | 81,231,736 | 52,901,853 |
| Trading assets, at fair value | 274,995 | 294,381 |
| Securities available for sale, at estimated fair value | 253,668,954 | 280,869,810 |
| Securities held to maturity, estimated fair value of \$6,881,172 at September 30, 2012 and \$9,175,956 at December 31, 2011 | 6,162,503 | 8,311,921 |
| Federal Home Loan Bank and Federal Reserve Bank Stock, at cost | 4,760,500 | 5,509,350 |
| Loans, net of deferred origination fees and costs, and unearned income | 876,358,135 | 796,915,177 |
| Allowance for loan losses | (10,827,971) | (9,659,320) |
| Loans, net | 865,530,164 | 787,255,857 |
| Loans held for sale | 1,164,750 | 395,427 |
| Premises and equipment, net | 24,862,825 | 24,762,405 |
| Goodwill | 21,824,443 | 21,983,617 |
| Other intangible assets, net | 5,382,282 | 6,190,540 |
| Bank owned life insurance | 2,689,944 | 2,625,104 |
| Other assets | 19,426,761 | 25,159,322 |
| Total assets | \$ 1,286,979,857 | \$ 1,216,259,587 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits: | | |
| Non-interest-bearing | \$ 302,508,720 | \$ 258,835,961 |
| Interest-bearing | 780,666,800 | 739,656,878 |
| Total deposits | 1,083,175,520 | 998,492,839 |

| | | |
|--|---------------|---------------|
| Securities sold under agreements to repurchase | 32,917,656 | 37,106,842 |
| Federal Home Loan Bank term advances | 28,045,741 | 43,343,918 |
| Accrued interest payable | 462,902 | 800,148 |
| Dividends payable | 1,143,770 | 1,141,081 |
| Other liabilities | 8,354,161 | 9,445,319 |
| Total liabilities | 1,154,099,750 | 1,090,330,147 |

Shareholders' equity:

| | | |
|--|------------------|------------------|
| Common stock, \$.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at September 30, 2012 and December 31, 2011 | 53,101 | 53,101 |
| Additional-paid-in capital | 45,537,843 | 45,582,861 |
| Retained earnings | 106,091,543 | 100,628,900 |
| Treasury stock, at cost (734,997 shares at September 30, 2012; 741,003 shares at December 31, 2011) | (18,730,525) | (18,894,044) |
| Accumulated other comprehensive income (loss) | (71,855) | (1,441,378) |
| Total shareholders' equity | 132,880,107 | 125,929,440 |
| Total liabilities and shareholders' equity | \$ 1,286,979,857 | \$ 1,216,259,587 |

See accompanying notes to unaudited consolidated financial statements.

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

| | Nine Months Ended | | Three Months Ended | |
|---|-------------------|------------------|--------------------|------------------|
| | September 30, | September 30, | September 30, | September 30, |
| | 2012 | 2011 | 2012 | 2011 |
| Interest and dividend income: | | | | |
| Loans, including fees | \$34,078,132 | \$31,456,406 | \$11,373,583 | \$11,673,216 |
| Taxable securities | 4,142,224 | 4,347,409 | 1,306,484 | 1,504,393 |
| Tax exempt securities | 976,622 | 1,035,068 | 300,374 | 350,557 |
| Interest-bearing deposits | 122,693 | 166,955 | 34,573 | 65,139 |
| Total interest and dividend income | 39,319,671 | 37,005,838 | 13,015,014 | 13,593,305 |
| Interest expense: | | | | |
| Deposits | 2,532,630 | 3,325,900 | 774,741 | 1,138,130 |
| Borrowed funds | 868,131 | 783,022 | 234,155 | 285,084 |
| Securities sold under agreements to repurchase | 763,343 | 1,056,095 | 231,043 | 326,542 |
| Total interest expense | 4,164,104 | 5,165,017 | 1,239,939 | 1,749,756 |
| Net interest income | 35,155,567 | 31,840,821 | 11,775,075 | 11,843,549 |
| Provision for loan losses | 753,897 | 833,333 | 225,000 | 583,333 |
| Net interest income after provision for loan losses | 34,401,670 | 31,007,488 | 11,550,075 | 11,260,216 |
| Other operating income: | | | | |
| Wealth management group fee income | 5,170,016 | 5,131,119 | 1,667,628 | 1,746,958 |
| Service charges on deposit accounts | 3,143,061 | 3,180,733 | 1,110,897 | 1,130,824 |
| Net gain on securities transactions | 300,516 | 1,108,091 | 597 | 428,882 |
| Other-than-temporary loss on investment securities: | | | | |
| Total impairment losses | - | (67,400) | - | (67,400) |
| Loss recognized in other comprehensive income | - | - | - | - |
| Net impairment loss recognized in earnings | - | (67,400) | - | (67,400) |
| | 270,265 | 132,902 | 125,885 | 53,571 |

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| | | | | |
|--|--------------|--------------|--------------|--------------|
| Net gain on sales of loans held for sale | | | | |
| Casualty gains | 790,248 | - | 9,813 | - |
| Gains on sales of other real estate owned | 20,426 | 89,404 | - | 442 |
| Income from bank owned life insurance | 64,840 | 65,932 | 21,571 | 22,321 |
| Other | 3,328,329 | 3,779,231 | 1,123,830 | 1,012,865 |
| Total other operating income | 13,087,701 | 13,420,012 | 4,060,221 | 4,328,463 |
| Other operating expenses: | | | | |
| Salaries and wages | 13,710,584 | 12,534,215 | 4,661,858 | 4,272,613 |
| Pension and other employee benefits | 4,137,878 | 3,296,814 | 1,381,401 | 1,172,044 |
| Net occupancy expenses | 3,849,173 | 3,663,005 | 1,269,165 | 1,230,490 |
| Furniture and equipment expenses | 1,599,842 | 1,549,048 | 503,995 | 486,518 |
| Data processing expense | 3,279,379 | 2,881,150 | 971,601 | 976,050 |
| Amortization of intangible assets | 808,258 | 753,192 | 260,069 | 288,001 |
| Marketing and advertising expense | 915,632 | 790,797 | 270,567 | 307,986 |
| Losses on sales of other real estate owned | 92,430 | 1,671 | 67,503 | - |
| Other real estate owned expenses | 286,137 | 86,040 | 154,238 | 37,549 |
| FDIC insurance | 615,360 | 737,281 | 205,317 | 294,897 |
| Merger related expenses | 30,145 | 2,243,919 | 21,600 | 20,500 |
| Other | 4,874,856 | 4,724,854 | 1,625,686 | 1,530,740 |
| Total other operating expenses | 34,199,674 | 33,261,986 | 11,393,000 | 10,617,388 |
| Income before income tax expense | 13,289,697 | 11,165,514 | 4,217,296 | 4,971,291 |
| Income tax expense | 4,397,279 | 3,589,455 | 1,383,451 | 1,680,351 |
| Net income | \$ 8,892,418 | \$ 7,576,059 | \$ 2,833,845 | \$ 3,290,940 |
| Weighted average shares outstanding | 4,639,985 | 4,297,777 | 4,641,547 | 4,637,392 |
| Basic and diluted earnings per share | \$ 1.92 | \$ 1.76 | \$ 0.61 | \$ 0.71 |

See accompanying notes to unaudited consolidated financial statements.

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

| | Nine Months Ended September 30 | | Three Months Ended September 30, | |
|---|-----------------------------------|--------------|-------------------------------------|-------------|
| | 2012 | 2011 | 2012 | 2011 |
| Net income | \$ 8,892,418 | \$ 7,576,059 | \$2,833,845 | \$3,290,940 |
| Other comprehensive income | | | | |
| Unrealized holding gains on securities available for sale | 1,633,195 | 5,448,351 | 959,668 | 294,210 |
| Change in unrealized gains (losses) on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in earnings, net of reclassification | - | 27,725 | - | (9,425) |
| Reclassification adjustment gains realized in net income | (300,516) | (1,108,091) | (597) | (428,882) |
| Net unrealized gains (losses) | 1,332,679 | 4,367,985 | 959,071 | (144,097) |
| Less: Tax effect | 544,460 | 1,689,798 | 368,668 | (55,746) |
| Net of tax amount | 788,219 | 2,678,187 | 590,403 | (88,351) |
| Change in funded status of defined benefit pension plan and other benefit plans | 944,286 | 464,097 | 314,762 | 154,699 |
| Less: Tax effect | 362,982 | 179,541 | 120,994 | 59,847 |
| Net of tax amount | 581,304 | 284,556 | 193,768 | 94,852 |
| Total other comprehensive income | 1,369,523 | 2,962,743 | 784,171 | 6,501 |
| Comprehensive income | \$10,261,941 | \$10,538,802 | \$3,618,016 | \$3,297,441 |

See accompanying notes to unaudited consolidated financial statements.

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

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total |
|--|-----------------|----------------------------------|----------------------|-------------------|---|---------------|
| Balances at December 31, 2010 | \$ 43,001 | \$ 22,022,122 | \$ 94,407,620 | \$ (19,166,655) | \$ 102,475 | \$ 97,408,563 |
| Net income | - | - | 7,576,059 | - | - | 7,576,059 |
| Other comprehensive income | - | - | - | - | 2,962,743 | 2,962,743 |
| Restricted stock awards | - | 21,226 | - | - | - | 21,226 |
| Restricted stock units for directors' deferred compensation plan | - | 61,129 | - | - | - | 61,129 |
| Cash dividends declared (\$.75 per share) | - | - | (3,175,394) | - | - | (3,175,394) |
| Distribution of 10,378 shares of treasury stock for directors' compensation | - | (33,831) | - | 265,262 | - | 231,431 |
| Distribution of 2,392 shares of treasury stock for employee compensation | - | (6,140) | - | 61,140 | - | 55,000 |
| Distribution of 286 shares of treasury stock for deferred directors' compensation | - | (7,364) | - | 7,310 | - | (54) |
| Distribution of 4,387 shares of treasury stock for employee restricted stock awards | - | (60,800) | - | 112,090 | - | 51,290 |
| Purchase of 13,981 shares of | - | - | - | (327,413) | - | (327,413) |

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| | | | | | | |
|---|-----------|---------------|----------------|-----------------|----------------|----------------|
| treasury stock | | | | | | |
| Sale of 3,900 shares of treasury stock | - | (10,101) | - | 99,606 | - | 89,505 |
| Issuance of 1,009,942 shares related to FOFC Merger | 10,100 | 23,723,538 | - | - | - | 23,733,638 |
| Balances at September 30, 2011 | \$ 53,101 | \$ 45,709,779 | \$ 98,808,285 | \$ (18,948,660) | \$ 3,065,218 | \$ 128,687,723 |
| Balances at December 31, 2011 | \$ 53,101 | \$ 45,582,861 | \$ 100,628,900 | \$ (18,894,044) | \$ (1,441,378) | \$ 125,929,440 |
| Net income | - | - | 8,892,418 | - | - | 8,892,418 |
| Other comprehensive income | - | - | - | - | 1,369,523 | 1,369,523 |
| Restricted stock awards | - | 61,062 | - | - | - | 61,062 |
| Restricted stock units for directors' deferred compensation plan | - | 65,151 | - | - | - | 65,151 |
| Cash dividends declared (\$.75 per share) | - | - | (3,429,775) | - | - | (3,429,775) |
| Distribution of 10,238 shares of treasury stock for directors' compensation | - | (28,121) | - | 261,069 | - | 232,948 |
| Distribution of 3,453 shares of treasury stock for employee compensation | - | (8,052) | - | 88,052 | - | 80,000 |
| Distribution of 3,240 shares of treasury stock for deferred directors' compensation | - | (81,747) | - | 82,588 | - | 841 |
| Distribution of 2,095 shares of treasury stock for employee | - | (53,412) | - | 53,412 | - | - |

| | | | | | | |
|--|-----------|---------------|----------------|-----------------|-------------|----------------|
| restricted stock awards | | | | | | |
| Purchase of 23,120 shares of treasury stock | - | - | - | (579,051) | - | (579,051) |
| Sale of 10,100 shares of treasury stock | - | 101 | - | 257,449 | - | 257,550 |
| Balances at September 30, 2012 | \$ 53,101 | \$ 45,537,843 | \$ 106,091,543 | \$ (18,730,525) | \$ (71,855) | \$ 132,880,107 |
| See accompanying notes to unaudited consolidated financial statements. | | | | | | |

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

Nine Months Ended
September 30,

| CASH FLOWS FROM OPERATING ACTIVITIES: | 2012 | 2011 |
|---|--------------|--------------|
| Net income | \$ 8,892,418 | \$ 7,576,059 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of intangible assets | 808,258 | 753,192 |
| Provision for loan losses | 753,897 | 833,333 |
| Depreciation and amortization of fixed assets | 2,187,234 | 2,129,738 |
| Amortization of premiums on securities, net | 1,343,743 | 960,973 |
| Gains on sales of loans held for sale, net | (270,265) | (132,902) |
| Proceeds from sales of loans held for sale | 8,992,854 | 5,523,214 |
| Loans originated and held for sale | (9,491,912) | (4,977,727) |
| Net losses (gains) on sale of other real estate owned | 72,004 | (87,733) |
| Net (gains) losses on trading assets | (28,261) | 14,966 |
| Net gains on securities transactions | (300,516) | (1,108,091) |
| Net impairment loss recognized on investment securities | - | 67,400 |
| Proceeds from sales of trading assets | 96,498 | - |
| Purchase of trading assets | (48,851) | (264,244) |
| Decrease in other assets | 4,294,238 | 3,001,325 |
| Decrease (increase) in prepaid FDIC assessment | 559,406 | (49,464) |
| Decrease in accrued interest payable | (337,246) | (265,000) |
| Expense related to restricted stock units for directors' deferred compensation plan | 65,151 | 61,129 |
| Expense related to employee stock compensation | 80,000 | 55,000 |
| Expense related to employee stock awards | 61,062 | 21,226 |
| Decrease in other liabilities | (820,424) | (2,243,010) |
| Income from bank owned life insurance | (64,840) | (65,932) |
| Net cash provided by operating activities | 16,844,448 | 11,803,452 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| | 70,370,086 | 67,741,210 |

| | | |
|---|---------------|--------------|
| Proceeds from sales and calls of securities available for sale | | |
| Proceeds from maturities and principal collected on securities available for sale | 21,396,640 | 23,608,123 |
| Proceeds from maturities and principal collected on securities held to maturity | 3,731,924 | 3,448,732 |
| Purchases of securities available for sale | (64,276,418) | (95,911,022) |
| Purchases of securities held to maturity | (1,582,507) | (3,319,281) |
| Purchase of Federal Home Loan Bank and Federal Reserve Bank stock | (26,250) | (1,002,500) |
| Redemption of Federal Home Loan Bank and Federal Reserve Bank stock | 775,100 | 237,250 |
| Purchases of premises and equipment | (2,287,654) | (1,307,723) |
| Cash paid Fort Orange Financial Corporation acquisition | - | (8,137,816) |
| Cash received Fort Orange Financial Corporation acquisition | - | 33,284,995 |
| Proceeds from sales of other real estate owned | 294,229 | 356,207 |
| Net increase in loans | (78,356,344) | (10,967,168) |
| Net cash (used) provided by investing activities | (49,961,194) | 8,031,007 |

CASH FLOWS FROM FINANCING ACTIVITIES:

| | | |
|--|--------------|--------------|
| Net increase in demand deposits, NOW accounts, savings accounts, and insured money market accounts | 112,724,881 | 70,452,474 |
| Net decrease in time deposits and individual retirement accounts | (28,042,200) | (15,073,756) |
| Net decrease in securities sold under agreements to repurchase | (4,189,186) | (13,889,730) |
| Repayments of Federal Home Loan Bank long term advances | (15,298,177) | (317,990) |
| Purchase of treasury stock | (579,051) | (327,413) |
| Sale of treasury stock | 257,449 | 89,505 |
| Cash dividends paid | (3,427,087) | (2,914,582) |
| Net cash provided by financing activities | 61,446,629 | 38,018,508 |
| Net increase in cash and cash equivalents | 28,329,883 | 57,852,967 |
| Cash and cash equivalents, beginning of period | 52,901,853 | 60,619,777 |

| | | |
|--|---------------|---------------|
| Cash and cash equivalents, end of period | \$ 81,231,736 | \$118,472,744 |
|--|---------------|---------------|

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(continued)

Supplemental disclosure of cash flow
information:

Cash paid during the year for:

| | | |
|--------------|-------------|-------------|
| Interest | \$4,501,350 | \$5,126,397 |
| Income Taxes | \$ 3,500 | \$3,340,847 |

Supplemental disclosure of non-cash activity:

| | | |
|--|------------|------------|
| Transfer of loans to other real estate owned | \$ 512,686 | \$ 308,976 |
|--|------------|------------|

See accompanying notes to unaudited
consolidated financial statements.

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CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

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

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

The consolidated financial statements included herein reflect all adjustments which are, in the opinion of management, of a normal recurring nature and necessary to present fairly the Corporation's financial position as of September 30, 2012 and December 31, 2011, and results of operations for the three and nine-month periods ended September 30, 2012 and 2011, and changes in shareholders' equity and cash flows for the nine-month periods ended September 30, 2012 and 2011. Subsequent events were evaluated for any required recognition or disclosure. The results for the periods presented are not necessarily indicative of results to be expected for the entire fiscal year or any other interim period.

2. Earnings Per Common Share

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors' restricted stock units and directors' stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities. The impact of the participating securities on earnings per share is not material. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,639,985 and 4,297,777 weighted average shares outstanding for the nine-month periods ended September 30, 2012 and 2011, respectively and 4,641,547 and 4,637,392 weighted average shares outstanding for the three-month periods ended September 30, 2012 and 2011, respectively. There were no dilutive common stock equivalents during the three and nine-month periods ended September 30, 2012 or 2011.

3. Adoption of New Accounting Standards

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

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

4. Fair Value

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

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

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

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

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

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

The Corporation's investment in collateralized debt obligations consisting of pooled trust preferred securities which are issued by financial institutions were historically priced using Level 2 inputs. The lack of observable inputs and market activity in this class of investments has been significant and resulted in unreliable external pricing. Broker pricing and bid/ask spreads, when available, have varied widely. The once active market has become comparatively inactive. As a result, these investments are now priced using Level 3 inputs.

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

Trading Assets: 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:

| Financial Assets: | Fair Value | Fair Value Measurement at September 30, 2012 Using | | |
|---|----------------|--|---|--|
| | | 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 | \$ 146,650,654 | \$ 37,917,000 | \$ 108,733,654 | \$ - |
| Mortgage-backed securities, residential | 36,285,767 | - | 36,285,767 | - |
| Obligations of states and political subdivisions | 41,609,614 | - | 41,609,614 | - |
| Collateralized mortgage obligations | 4,727,378 | - | 4,727,378 | - |
| Corporate bonds and notes | 13,764,840 | - | 13,764,840 | - |
| SBA loan pools | 1,783,390 | - | 1,783,390 | - |
| Trust Preferred securities | 2,462,006 | - | 2,016,406 | 445,600 |
| Corporate stocks | 6,385,305 | 5,731,308 | 653,997 | - |
| Total available for sale securities | \$ 253,668,954 | \$ 43,648,308 | \$ 209,575,046 | \$ 445,600 |
| Trading assets | \$ 274,995 | \$ 274,995 | \$ - | \$ - |

| Financial Assets: | Fair Value | Fair Value Measurement at December 31, 2011 Using | | |
|-------------------|------------|--|----------------------|-----------------------------|
| | | Quoted Prices | Significant Other | Significant Unobservable |

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| | | in Active Markets for Identical Assets (Level 1) | Observable Inputs (Level 2) | Inputs (Level 3) |
|--|----------------|--|-----------------------------------|---------------------|
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 152,079,770 | \$ 35,950,000 | \$ 116,129,770 | \$ - |
| Mortgage-backed securities, residential | 50,766,604 | - | 50,766,604 | - |
| Obligations of states and political subdivisions | 46,512,971 | - | 46,512,971 | - |
| Trust Preferred securities | 2,310,066 | - | 2,015,156 | 294,910 |
| Corporate bonds and notes | 13,684,199 | - | 13,684,199 | - |
| Collateralized mortgage obligations | 7,536,753 | - | 7,536,753 | - |
| SBA loan pools | 1,949,606 | - | 1,949,606 | - |
| Corporate stocks | 6,029,841 | 5,339,839 | 690,002 | - |
| Total available for sale securities | \$ 280,869,810 | \$ 41,289,839 | \$ 239,285,061 | \$ 294,910 |
| Trading assets | \$ 294,381 | \$ 294,381 | \$ - | \$ - |

There were no transfers between Level 1 and Level 2 during the three or nine-month periods ending September 30, 2012 or the year ending December, 31, 2011.

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

The tables below present a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine-month periods ending September 30, 2012 and 2011:

| | Fair Value Measurement for Nine-Months Ended September 30, 2012 Using Significant Unobservable Inputs (Level 3) | Fair Value Measurement for Nine-Months Ended September 30, 2011 Using Significant Unobservable Inputs (Level 3) |
|--|--|---|
| Trust Preferred Securities Available for Sale | | |
| Beginning balance | \$ 294,910 | \$ 334,585 |
| Total gains/losses (realized/unrealized): | | |
| Included in earnings: | | |
| Income on securities | - | - |
| Impairment charge on investment securities | - | (67,400) |
| Included in other comprehensive income | 150,690 | 27,725 |
| Transfers in and/or out of Level 3 | - | - |
| Ending balance September 30 | \$ 445,600 | \$ 294,910 |

| Fair Value Measurement for Three-Months Ended September 30, 2012 Using | Fair Value Measurement for Three-Months Ended September 30, 2011 Using |
|--|--|
|--|--|

| | Significant Unobservable Inputs (Level 3) | Significant Unobservable Inputs (Level 3) |
|---|---|--|
| Trust Preferred Securities Available for Sale | | |
| Beginning balance | \$ 343,035 | \$ 371,735 |
| Total gains/losses (realized/unrealized): | | |
| Included in earnings: | | |
| Income on securities | - | - |
| Impairment charge on investment securities | - | (67,400) |
| Included in other comprehensive income | 102,565 | (9,425) |
| Transfers in and/or out of Level 3 | - | - |
| Ending balance September 30 | \$ 445,600 | \$ 294,910 |

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

| | | Fair Value Measurement at September 30, 2012 Using | | |
|---|--------------|---|--|--|
| | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Financial Assets: | | | | |
| Impaired Loans: | | | | |
| Commercial, financial and agricultural: | | | | |
| Commercial and industrial | \$ 1,324,350 | \$ - | \$ - | \$ 1,324,350 |
| Commercial mortgages: | | | | |
| Other | 423,036 | - | - | 423,036 |
| Total Impaired Loans | \$ 1,747,386 | \$ - | \$ - | \$ 1,747,386 |
| Other real estate owned: | | | | |
| Commercial, financial and agricultural: | | | | |
| Commercial and industrial | \$ 101,200 | \$ - | \$ - | \$ 101,200 |
| Commercial mortgages: | | | | |
| Other | 400,755 | - | - | 400,755 |
| Residential mortgages | 427,871 | - | - | 427,871 |
| Consumer loans: | | | | |
| Home equity lines & loans | 4,000 | - | - | 4,000 |
| Total Other real estate owned, net | \$ 933,826 | \$ - | \$ - | \$ 933,826 |

| | | Fair Value Measurement at December 31, 2011 Using | | |
|-------------------|------------|--|--|--|
| | Fair Value | Quoted Prices in Active Markets | Significant Other Observable Inputs | Significant Unobservable Inputs (Level 3) |
| Financial Assets: | | | | |

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| | for Identical Assets (Level 1) | | (Level 2) | |
|---|--|------|--------------|--------------|
| Impaired Loans: | | | | |
| Commercial, financial and agricultural: | | | | |
| Commercial and industrial | \$ 831,601 | \$ - | \$ - | \$ 831,601 |
| Commercial mortgages: | | | | |
| Other | 3,321,838 | - | - | 3,321,838 |
| Total Impaired Loans | \$ 4,153,439 | \$ - | \$ - | \$ 4,153,439 |
| Other real estate owned: | | | | |
| Commercial, financial and agricultural: | | | | |
| Commercial and industrial | \$ 218,040 | \$ - | \$ - | \$ 218,040 |
| Commercial mortgages: | | | | |
| Other | 366,760 | - | - | 366,760 |
| Residential mortgages | 276,355 | - | - | 276,355 |
| Consumer loans: | | | | |
| Home equity lines & loans | 36,600 | - | - | 36,600 |
| Total Other real estate owned, net | \$ 897,755 | \$ - | \$ - | \$ 897,755 |

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$2,790,932 with a valuation allowance of \$1,043,546 as of September 30, 2012, resulting in no additional provision for loan losses for the three and nine-month periods ending September 30, 2012. Impaired loans had a principal balance of \$6,095,645, with a valuation allowance of \$1,942,206 as of December 31, 2011, resulting in a \$958,333 provision for loan losses for the year ending December 31, 2011.

OREO, which is measured by the lower of carrying or fair value less costs to sell, had a net carrying amount of \$933,826 at September 30, 2012. The net carrying amount reflects the outstanding balance of \$1,126,193 net of a valuation allowance of \$192,367 at September 30, 2012, which resulted in a write down of \$96,600 and \$116,840 for the three and nine-month periods ending September 30, 2012.

OREO had a net carrying amount of \$897,755 at December 31, 2011. The net carrying amount reflects the outstanding balance of \$1,009,162 net of a valuation allowance of \$111,407 at December 31, 2011, which resulted in write downs of \$12,120 for the year ending December 31, 2011.

The carrying amounts and estimated fair values of other financial instruments, at September 30, 2012 and December 31, 2011, are as follows (dollars in thousands):

| Financial assets: | Carrying Amount | Fair Value Measurements at September 30, 2012 Using | | | | Estimated Fair Value (1) |
|---|-----------------|--|----------------------------|------------------|---|--------------------------|
| | | Quoted Prices in Active Significant Markets for Observable | Identical Assets (Level 1) | Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Cash and due from financial institutions | \$ 35,324 | \$ 35,324 | \$ - | | -\$ - | 35,324 |
| Interest-bearing deposits in other financial institutions | 45,908 | 42,796 | 3,112 | | - | 45,908 |
| Trading assets | 275 | 275 | - | | - | 275 |
| Securities available for sale | 253,669 | 43,648 | 209,575 | | 446 | 253,669 |
| Securities held to maturity | 6,163 | - | 6,881 | | - | 6,881 |
| Federal Home Loan and Federal Reserve Bank stock | 4,761 | - | - | | - | N/A |

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| | | | | | |
|--|---------|---------|---------|---------|---------|
| Net loans | 865,530 | - | - | 899,909 | 899,909 |
| Loans held for sale | 1,165 | - | 1,165 | - | 1,165 |
| Accrued interest receivable | 4,411 | 333 | 1,634 | 2,444 | 4,411 |
| Financial liabilities: | | | | | |
| Deposits: | | | | | |
| Demand, savings, and insured money market accounts | 834,228 | 834,228 | - | - | 834,228 |
| Time deposits | 248,948 | - | 250,568 | - | 250,568 |
| Securities sold under agreements to repurchase | 32,918 | - | 35,671 | - | 35,671 |
| Federal Home Loan Bank advances | 28,046 | - | 30,740 | - | 30,740 |
| Accrued interest payable | 463 | 15 | 448 | - | 463 |
| Dividends payable | 1,144 | 1,144 | - | - | 1,144 |

| | December 31, 2011 | |
|---|--------------------|--------------------------------|
| | Carrying Amount | Estimated Fair Value (1) |
| Financial assets: | | |
| Cash and due from financial institutions | \$ 28,205 | \$ 28,205 |
| Interest-bearing deposits in other financial institutions | 24,697 | 24,697 |
| Trading assets | 294 | 294 |
| Securities available for sale | 280,870 | 280,870 |
| Securities held to maturity | 8,312 | 9,176 |
| Federal Home Loan and Federal Reserve Bank stock | 5,509 | N/A |
| Net loans | 787,256 | 805,760 |
| Loans held for sale | 395 | 395 |
| Accrued interest receivable | 3,882 | 3,882 |

Financial liabilities:**Deposits:**

| | | |
|--|---------|---------|
| Demand, savings, and insured money market accounts | 721,503 | 721,503 |
| Time deposits | 276,990 | 279,441 |
| Securities sold under agreements to repurchase | 37,107 | 40,019 |
| Federal Home Loan Bank advances | 43,344 | 46,603 |
| Accrued interest payable | 800 | 800 |
| Dividends payable | 1,141 | 1,141 |

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

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

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

For those short-term instruments that generally mature in 90 days or less, the carrying value approximates fair value of which non interest-bearing deposits are classified as Level 1 and interest-bearing deposits with the Federal Home Loan Bank of New York (“FHLB”) and Federal Reserve Bank of New York (“FRB”) are classified as Level 1, and time deposits are classified as Level 2.

FHLB and FRB Stock

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

Loans Receivable

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

Deposits

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

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

Securities Sold Under Agreements to Repurchase (Repurchase Agreements)

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

Federal Home Loan Bank Advances

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

Accrued Interest Receivable and Payable

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

5. Goodwill and Intangible Assets

The changes in goodwill included in the core banking segment during the periods ending September 30, 2012 and 2011 were as follows:

| | 2012 | 2011 |
|-------------------------------------|---------------|---------------|
| Beginning of year | \$ 21,983,617 | \$ 9,872,375 |
| Acquired goodwill | - | 12,284,838 |
| Adjustment of Acquired goodwill (1) | (159,174) | - |
| September 30, | \$ 21,824,443 | \$ 22,157,213 |

(1) Adjustment related to Fort Orange Financial Corp. acquisition.

Acquired intangible assets were as follows at September 30, 2012 and December 31, 2011:

| At September 30, 2012 | | At December 31, 2011 | |
|-----------------------|--------------|----------------------|--------------|
| Balance | Accumulated | Balance | Accumulated |
| Acquired | Amortization | Acquired | Amortization |

| | | | | |
|--------------|--------------|--------------|--------------|--------------|
| Core deposit | | | | |
| intangibles | \$ 3,819,798 | \$ 1,655,826 | \$ 3,819,798 | \$ 1,213,118 |
| Other | | | | |
| customer | | | | |
| relationship | | | | |
| intangibles | 6,063,423 | 2,845,113 | 6,063,423 | 2,479,563 |
| Total | \$ 9,883,221 | \$ 4,500,939 | \$ 9,883,221 | \$ 3,692,681 |

Aggregate amortization expense was \$808,258 and \$753,192 for the nine-month periods ended September 30, 2012 and 2011, respectively.

The remaining estimated aggregate amortization expense at September 30, 2012 is listed below:

| Year | Estimated Expense |
|---------------------|-------------------|
| 2012 | \$ 238,462 |
| 2013 | 876,524 |
| 2014 | 777,801 |
| 2015 | 681,176 |
| 2016 | 607,713 |
| 2017 and thereafter | 2,200,606 |
| Total | \$ 5,382,282 |

6. Accumulated Other Comprehensive Income or Loss

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

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

| | Balance at December 31, 2011 | Current Period Change | Balance at September 30, 2012 |
|--|------------------------------------|--------------------------|-------------------------------------|
| Unrealized gains on securities available for sale | \$ 7,987,055 | \$ 788,219 | \$ 8,775,274 |
| Unrealized loss on pension plans and other benefit plans | (9,428,433) | 581,304 | (8,847,129) |
| Total | \$ (1,441,378) | \$ 1,369,523 | \$ (71,855) |

7. Commitments and Contingencies

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

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

In the normal course of business, there are various outstanding claims and legal proceedings involving the Corporation or its subsidiaries. Except for the above matter, we believe that we are not a party to any pending legal, arbitration, or regulatory proceedings that could have a material adverse impact on our financial results or liquidity.

8. Securities

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

| | Amortized Cost | September 30, 2012 Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|-------------------|---|----------------------|-------------------------|
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 142,730,477 | \$ 3,920,177 | \$ - | \$ 146,650,654 |
| Mortgage-backed securities, residential | 33,801,646 | 2,484,121 | - | 36,285,767 |
| Collateralized Mortgage obligations | 4,653,401 | 74,909 | 931 | 4,727,379 |
| Obligations of states and political subdivisions | 39,800,910 | 1,810,542 | 1,838 | 41,609,614 |
| | 13,421,730 | 346,574 | 3,464 | 13,764,840 |

| | | | | |
|----------------------------|----------------|---------------|------------|----------------|
| Corporate bonds and notes | | | | |
| SBA loan pools | 1,743,803 | 39,587 | - | 1,783,390 |
| Trust Preferred securities | 2,517,440 | 127,991 | 183,425 | 2,462,006 |
| Corporate stocks | 744,715 | 5,645,849 | 5,260 | 6,385,304 |
| Total | \$ 239,414,122 | \$ 14,449,750 | \$ 194,918 | \$ 253,668,954 |

| | December 31, 2011 | | | |
|---|-------------------|---------------------|----------------------|-------------------------|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 149,140,715 | \$ 3,022,726 | \$ 83,671 | \$ 152,079,770 |
| Mortgage-backed securities, residential | 48,129,271 | 2,637,334 | - | 50,766,605 |
| Collateralized mortgage obligations | 7,412,471 | 135,603 | 11,321 | 7,536,753 |
| Obligations of states and political subdivisions | 44,561,789 | 1,954,265 | 3,083 | 46,512,971 |
| Corporate bonds and notes | 13,461,675 | 418,969 | 196,446 | 13,684,198 |
| SBA loan pools | 1,915,419 | 34,187 | - | 1,949,606 |
| Trust preferred securities | 2,538,285 | 132,516 | 360,735 | 2,310,066 |
| Corporate stocks | 788,030 | 5,246,655 | 4,844 | 6,029,841 |
| Total | \$ 267,947,655 | \$ 13,582,255 | \$ 660,100 | \$ 280,869,810 |

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

| | September 30, 2012 | | | |
|--|--------------------|---------------------|----------------------|-------------------------|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of states and political subdivisions | \$ 6,162,503 | \$ 718,669 | \$ - | \$ 6,881,172 |

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

The amortized cost and estimated fair value of debt securities are shown below by expected maturity.

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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:

| | September 30, 2012 | | | |
|---|--------------------|----------------|-------------------|---------------|
| | Available for Sale | | Held to Maturity | |
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Within One Year | \$ 58,024,142 | \$ 58,383,376 | \$ 1,606,365 | \$ 1,633,074 |
| After One, But Within Five Years | 133,178,606 | 138,326,611 | 3,147,444 | 3,490,139 |
| After Five, But Within Ten Years | 6,638,784 | 7,331,527 | 1,408,694 | 1,757,959 |
| After Ten Years | 629,025 | 445,600 | - | - |
| Mortgage-backed securities, residential | 33,801,646 | 36,285,767 | - | - |
| Collateralized mortgage obligations | 4,653,401 | 4,727,379 | - | - |
| SBA loan pools | 1,743,803 | 1,783,390 | - | - |
| Total | \$ 238,669,407 | \$ 247,283,650 | \$ 6,162,503 | \$ 6,881,172 |

Proceeds from sales and calls of securities available for sale for the three and nine months ended September 30, 2012 were \$1,002,052 and \$70,370,086, respectively. Realized gross gains on these sales and calls were \$597 and \$300,516 during the three and nine month periods ended September 30, 2012, respectively. There were no sales or calls of securities available for sale that resulted in losses for the three or nine-months ended September 30, 2012.

Proceeds from sales and calls of securities available for sale for the three and nine months ended September 30, 2011, were \$11,085,156 and \$67,741,210, respectively. Realized gross gains on these sales and calls were \$428,882 and \$1,108,091 during the three and nine month periods ended September 30, 2011, respectively. There were no sales or calls of securities available for sale that resulted in losses for the three or nine-months ended September 30, 2011.

The following tables summarize the investment securities available for sale and held to maturity with unrealized losses at September 30, 2012 and December 31, 2011 by aggregated major security type and length of time in a continuous unrealized loss position:

| September 30, 2012 | Less than 12 months | | 12 months or longer | | Total | |
|---|------------------------|----------------------|---------------------|----------------------|--------------|----------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Collateralized mortgage obligations | \$ 22,087 | 70 | \$ 178,729 | \$ 861 | \$ 200,816 | \$ 931 |
| Obligations of states and political subdivisions | 430,847 | 1,838 | - | - | 430,847 | 1,838 |
| Corporate bonds and notes | - | - | 494,297 | 3,464 | 494,297 | 3,464 |
| Trust preferred securities | - | - | 445,600 | 183,425 | 445,600 | 183,425 |
| Corporate stocks | - | - | 48,370 | 5,260 | 48,370 | 5,260 |
| Total temporarily impaired securities | \$ 452,934 | \$ 1,908 | \$ 1,166,996 | \$ 193,010 | \$ 1,619,930 | \$ 194,918 |

| December 31, 2011 | Less than 12 months | | 12 months or longer | | Total | |
|--|---------------------|----------------------|---------------------|----------------------|--------------|----------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Government and U.S. | \$27,365,920 | \$ 83,671 | \$ - | \$ - | \$27,365,920 | \$ 83,671 |

| | | | | | | |
|--|--------------|-----------|-----------|-----------|--------------|-----------|
| Government sponsored enterprises | | | | | | |
| Collateralized mortgage obligations | 2,546,461 | 11,321 | - | - | 2,546,461 | 11,321 |
| Obligations of states and political subdivisions | 947,203 | 3,083 | - | - | 947,203 | 3,083 |
| Corporate bonds and notes | 5,261,074 | 196,446 | - | - | 5,261,074 | 196,446 |
| Trust preferred securities | - | - | 294,910 | 360,735 | 294,910 | 360,735 |
| Corporate stocks | 1,669 | 1,969 | 47,117 | 2,875 | 48,786 | 4,844 |
| Total temporarily impaired securities | \$36,122,327 | \$296,490 | \$342,027 | \$363,610 | \$36,464,354 | \$660,100 |

Other-Than-Temporary Impairment (“OTTI”)

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

As of September 30, 2012, the majority of the Corporation's unrealized losses in the investment securities portfolio related to one pooled trust preferred security. The decline in fair value on this security is primarily attributable to the financial crisis and resulting credit deterioration and financial condition of the underlying issuers, all of which are financial institutions. This deterioration may affect the future receipt of both principal and interest payments on this security. This fact combined with the current illiquidity in the market makes it unlikely that the Corporation would be able to recover its investment in this security if it was sold at this time.

Our analysis of this investment includes a \$629,025 book value collateralized debt obligation ("CDO") which is a pooled trust preferred security. This security was rated high quality at inception, but at September 30, 2012 Moody's rated this security as Caa3, which is defined as substantial risk of default. The Corporation uses the OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to determine if there are adverse changes in cash flows during each quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities.

Upon completion of the September 30, 2012 analysis, our model indicated no additional OTTI on this CDO. This security remained classified as available for sale and represented \$183,425 of the unrealized losses reported at September 30, 2012. Payments continue to be made as agreed on this security.

When conducting the September 30, 2012 analysis, the present value of expected future cash flows using a discount rate equal to the yield in effect at the time of purchase was compared to the previous quarters' analysis. The analysis indicated no further decline in value attributed to credit related factors stemming from further deterioration in the underlying collateral payment streams. Additionally, to estimate fair value the present value of the expected future cash flows was calculated using a current estimated discount rate that a willing market participant might use to value the security based on current market conditions and interest rates. This comparison indicated an increase in value during the quarter, based on factors other than credit, which resulted in a gain reported in other comprehensive income. Changes in credit quality may or may not correlate to changes in the overall fair value of the impaired securities as the change in credit quality is only one component in assessing the overall fair value of the impaired securities. Therefore, the recognition of additional credit related OTTI could result in a gain reported in other comprehensive income. Total OTTI recognized in accumulated other comprehensive income was \$111,329 and \$220,459 for securities available for sale at September 30, 2012 and December 31, 2011, respectively.

The tables below present a roll forward of the cumulative credit losses recognized in earnings for the three and nine-month periods ending September 30, 2012 and 2011:

| | 2012 | 2011 |
|---|--------------|--------------|
| Beginning balance, January 1, | \$ 3,506,073 | \$ 3,438,673 |
| Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized | - | - |
| Additions/Subtractions: | | |
| Amounts realized for securities sold during the period | - | - |
| Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis | - | - |
| Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security | - | - |
| Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized | - | 67,400 |
| Ending balance, September 30, | \$ 3,506,073 | \$ 3,506,073 |

| | | |
|---|--------------|--------------|
| Beginning balance, July 1, | \$ 3,506,073 | \$ 3,438,673 |
| Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized | - | - |
| Additions/Subtractions: | | |
| Amounts realized for securities sold during the period | - | - |
| Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis | - | - |
| Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security | - | - |
| Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized | - | 67,400 |
| Ending balance, September 30, | \$ 3,506,073 | \$ 3,506,073 |

9. Loans and Allowance for Loan Losses

The composition of the loan portfolio is summarized as follows:

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Commercial, financial and agricultural | \$ 133,365,046 | \$ 142,209,279 |
| Commercial mortgages | 311,126,130 | 264,589,013 |
| Residential mortgages | 193,049,212 | 193,599,853 |
| Indirect consumer loans | 130,969,296 | 97,165,447 |
| Consumer loans | 107,848,451 | 99,351,585 |
| | \$ 876,358,135 | \$ 796,915,177 |

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

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

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

Risk Characteristics

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

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

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

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

The following tables present activity in the allowance for loan losses for the three and nine months ending September 30, 2012, by portfolio segment and by loans originated by the Corporation (referred to as “Legacy” loans) and loans acquired (referred to as “Acquired” loans) in the merger with Fort Orange Financial Corp. (“FOFC”), which was completed on April 8, 2011. The allowance for loan losses on Acquired loans represents any valuation allowances established after acquisition for decreases in cash flows expected to be collected on purchased credit impaired loans.

In addition, the following tables present activity in the allowance for loan losses for the three and nine months ending September 30, 2011, by portfolio segment for Legacy loans. The allowance for loan losses on Acquired loans was established during the quarter ending March 31, 2012, therefore, there was no activity for the three and nine months ending September 30, 2011.

| Legacy Loans | Nine Months Ended September 30, 2012 | | | | | |
|------------------------------|---|-------------------------|--------------------------|-------------------|-------------|---------------|
| | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total |
| Allowance for loan losses | | | | | | |
| Beginning balance: | \$ 3,143,373 | \$ 2,570,149 | \$ 1,309,649 | \$ 2,192,729 | \$ 443,420 | \$ 9,659,320 |
| Charge | | | | | | |
| Offs: | (5,792) | (39,314) | (82,442) | (342,867) | - | (470,415) |
| Recoveries: | 591,497 | 43,031 | - | 176,139 | - | 810,667 |
| Net recoveries (charge offs) | 585,705 | 3,717 | (82,442) | (166,728) | - | 340,252 |
| Provision | (1,300,269) | 682,991 | 232,793 | 884,943 | 32,542 | 533,000 |
| Ending balance | \$ 2,428,809 | \$ 3,256,857 | \$ 1,460,000 | \$ 2,910,944 | \$ 475,962 | \$ 10,532,572 |

| Acquired Loans | Nine Months Ended September 30, 2012 | | | | | |
|--|---|-------------------------|--------------------------|-------------------|-------------|----------|
| | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total |
| Allowance for loan losses | | | | | | |
| Beginning balance: | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Reclassification of acquired loan discount | 73,228 | 50,331 | - | - | - | 123,559 |
| Charge Offs: | - | (49,057) | - | - | - | (49,057) |
| Recoveries: | - | - | - | - | - | - |
| Net recoveries | 73,228 | 1,274 | - | - | - | 74,502 |

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| | | | | | | |
|----------------|------------|-----------|------|------|------|------------|
| Provision | 134,427 | 86,470 | - | - | - | 220,897 |
| Ending balance | \$ 207,655 | \$ 87,744 | \$ - | \$ - | \$ - | \$ 295,399 |

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| Legacy Loans | | Three Months Ended September 30, 2012 | | | | | |
|------------------------------|--|--|-----------------------|----------------|-------------|---------------|--|
| Allowance for loan losses | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total | |
| Beginning balance: | \$ 2,796,556 | \$ 2,987,968 | \$ 1,424,816 | \$ 2,474,185 | \$ 413,648 | \$ 10,097,173 | |
| Charge Offs: | - | (31,019) | (9,829) | (69,439) | - | (110,287) | |
| Recoveries: | 239,735 | 12,535 | - | 68,416 | - | 320,686 | |
| Net recoveries (charge offs) | 239,735 | (18,484) | (9,829) | (1,023) | - | 210,399 | |
| Provision | (607,482) | 287,373 | 45,013 | 437,782 | 62,314 | 225,000 | |
| Ending balance | \$ 2,428,809 | \$ 3,256,857 | \$ 1,460,000 | \$ 2,910,944 | \$ 475,962 | \$ 10,532,572 | |

| Acquired Loans | | Three Months Ended September 30, 2012 | | | | | |
|--|--|--|-----------------------|----------------|-------------|------------|--|
| Allowance for loan losses | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total | |
| Beginning balance: | \$ 207,655 | \$ 87,744 | \$ - | \$ - | \$ - | \$ 295,399 | |
| Reclassification of acquired loan discount | - | - | - | - | - | - | |
| Charge Offs: | - | - | - | - | - | - | |
| Recoveries: | - | - | - | - | - | - | |
| Net charge offs | - | - | - | - | - | - | |
| Provision | - | - | - | - | - | - | |
| Ending balance | \$ 207,655 | \$ 87,744 | \$ - | \$ - | \$ - | \$ 295,399 | |

| Legacy Loans | | Nine Months Ended September 30, 2011 | | | | | |
|---------------------------|--|---|-----------------------|----------------|-------------|--------------|--|
| Allowance for loan losses | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total | |
| Beginning balance: | \$ 2,118,299 | \$ 2,575,058 | \$ 1,301,780 | \$ 2,727,022 | \$ 775,972 | \$ 9,498,131 | |
| Charge Offs: | (593,995) | (3,764) | (39,312) | (542,621) | - | (1,179,692) | |

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| | | | | | | |
|------------------------------|--------------|--------------|--------------|--------------|------------|--------------|
| Recoveries: | 314,797 | 33,304 | 30,324 | 146,726 | - | 525,151 |
| Net recoveries (charge offs) | (279,198) | 29,540 | (8,988) | (395,895) | - | (654,541) |
| Provision | 1,444,245 | (69,375) | (61,068) | (184,348) | (296,121) | 833,333 |
| Ending balance | \$ 3,283,346 | \$ 2,535,223 | \$ 1,231,724 | \$ 2,146,779 | \$ 479,851 | \$ 9,676,923 |

Legacy Loans

Three Months Ended September 30, 2011

| | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total |
|------------------------------|--|----------------------|-----------------------|----------------|-------------|--------------|
| Beginning balance: | \$ 3,081,433 | \$ 2,612,655 | \$ 1,246,880 | \$ 2,297,459 | \$ 517,245 | \$ 9,755,672 |
| Charge Offs: | (590,992) | - | (39,312) | (201,966) | - | (832,270) |
| Recoveries: | 109,391 | 7,201 | - | 53,596 | - | 170,188 |
| Net recoveries (charge offs) | (481,601) | 7,201 | (39,312) | (148,370) | - | (662,082) |
| Provision | 683,514 | (84,633) | 24,156 | (2,310) | (37,394) | 583,333 |
| Ending balance | \$ 3,283,346 | \$ 2,535,223 | \$ 1,231,724 | \$ 2,146,779 | \$ 479,851 | \$ 9,676,923 |

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The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment based on impairment method as of September 30, 2012 and December 31, 2011. The recorded investment excludes Acquired loans except for those loans acquired with deteriorated credit quality:

September 30, 2012

| Allowance for loan losses | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total |
|---|--|----------------------|-----------------------|----------------|-------------|---------------|
| Ending allowance balance attributable to loans: | | | | | | |
| Individually evaluated for impairment | \$ 946,255 | \$ 97,291 | \$ - | \$ - | \$ - | \$ 1,043,546 |
| Collectively evaluated for impairment | 1,482,554 | 3,159,566 | 1,460,000 | 2,910,944 | 475,962 | 9,489,026 |
| Acquired with deteriorated credit quality | 207,655 | 87,744 | - | - | - | 295,399 |
| Total ending allowance balance | \$ 2,636,464 | \$ 3,344,601 | \$ 1,460,000 | \$ 2,910,944 | \$ 475,962 | \$ 10,827,971 |

December 31, 2011

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

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September 30, 2012

| Loans: | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
|---|---|-------------------------|--------------------------|-------------------|----------------|
| Loans individually evaluated for impairment | \$ 2,445,154 | \$ 1,777,782 | \$ 136,844 | \$ - | \$ 4,359,780 |
| Loans collectively evaluated for impairment | 112,741,589 | 234,567,883 | 179,469,401 | 233,911,200 | 760,690,073 |
| Acquired with deteriorated credit quality | 1,152,448 | 11,400,980 | 239,911 | - | 12,793,339 |
| Total ending loans balance | \$ 116,339,191 | \$ 247,746,645 | \$ 179,846,156 | \$ 233,911,200 | \$ 777,843,192 |

December 31, 2011

| Loans: | Commercial, Financial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
|---|---|-------------------------|--------------------------|-------------------|----------------|
| Loans individually evaluated for impairment | \$ 5,275,043 | \$ 4,603,563 | \$ 179,337 | \$ - | \$ 10,057,943 |
| Loans collectively evaluated for impairment | 111,532,413 | 169,658,759 | 175,405,950 | 190,904,630 | 647,501,752 |
| Total ending loans balance | \$ 116,807,456 | \$ 174,262,322 | \$ 175,585,287 | \$ 190,904,630 | \$ 657,559,695 |

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The following tables present loans individually evaluated for impairment recognized by class of loans as of September 30, 2012 and December 31, 2011, the average recorded investment and interest income recognized by class of loans as of the three and nine-month periods ending September 30, 2012 and 2011:

| | September 30, 2012 | | | December 31, 2011 | | | |
|---|--------------------------------------|---------------------|--------------------------------------|--------------------------|-----------------------------|---------------------------------------|---------------------|
| | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated | |
| With no related allowance recorded: | | | | | | | |
| Commercial, financial and agricultural: | | | | | | | |
| Commercial & industrial | \$ 372,788 | \$ 174,129 | \$ - | \$ 3,512,860 | \$ 2,914,776 | \$ - | |
| Commercial mortgages: | | | | | | | |
| Construction | 10,454 | 10,454 | - | 10,454 | 10,454 | - | |
| Other | 1,854,966 | 1,246,775 | - | 1,091,026 | 860,648 | - | |
| Residential mortgages | 136,844 | 136,844 | - | 178,925 | 179,337 | - | |
| With an allowance recorded: | | | | | | | |
| Commercial, financial and agricultural: | | | | | | | |
| Commercial & industrial | 2,670,391 | 2,271,025 | 946,255 | 2,360,252 | 2,360,267 | 1,528,651 | |
| Commercial mortgages: | | | | | | | |
| Construction | - | - | - | 8,295 | 8,295 | 8,295 | |
| Other | 520,327 | 520,553 | 97,291 | 4,098,627 | 3,724,166 | 405,260 | |
| Total | \$ 5,565,770 | \$ 4,359,780 | \$ 1,043,546 | \$ 11,260,439 | \$ 10,057,943 | \$ 1,942,206 | |
| | | | | Three Months Ended | | | |
| | Nine Months Ended September 30, 2012 | | Nine Months Ended September 30, 2011 | | September 30, 2012 | Three Months Ended September 30, 2011 | |
| | Average Recorded Investment | Interest Recognized | Average Recorded Investment | Interest Recognized | Average Recorded Investment | Interest Recognized | Interest Recognized |
| With no related allowance recorded: | | | | | | | |
| Commercial, financial and | | | | | | | |

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agricultural:

| | | | | | | | | |
|----------------------------|------------|------|--------------|-----------|------------|-----|--------------|----------|
| Commercial & industrial | \$ 843,910 | \$ - | \$ 3,100,655 | \$ 25,049 | \$ 177,457 | \$- | \$ 3,032,483 | \$ 6,290 |
|----------------------------|------------|------|--------------|-----------|------------|-----|--------------|----------|

Commercial

mortgages:

| | | | | | | | | |
|--------------|---------|---|-----------|---|-----------|---|-----------|---|
| Construction | 10,454 | - | 24,490 | - | 10,454 | - | 20,602 | - |
| Other | 932,358 | - | 3,447,948 | - | 1,081,307 | - | 3,397,079 | - |

Residential

| | | | | | | | | |
|-----------|---------|---|---------|---|--------|---|---------|---|
| mortgages | 117,737 | - | 307,997 | - | 74,441 | - | 257,799 | - |
|-----------|---------|---|---------|---|--------|---|---------|---|

Consumer

loans:

| | | | | | | | | |
|------------------------------|--------|-------|---|---|---|---|---|---|
| Home equity lines & loans | 14,892 | 2,289 | - | - | - | - | - | - |
|------------------------------|--------|-------|---|---|---|---|---|---|

With an

allowance

recorded:

Commercial,

financial and

agricultural:

| | | | | | | | | |
|----------------------------|-----------|---|-----------|--------|-----------|---|-----------|--------|
| Commercial & industrial | 2,328,728 | - | 1,953,474 | 82,548 | 2,295,003 | - | 2,918,444 | 82,548 |
|----------------------------|-----------|---|-----------|--------|-----------|---|-----------|--------|

Commercial

mortgages:

| | | | | | | | | |
|--------------|-----------|---|---------|--------|---------|---|---------|--------|
| Construction | 4,148 | - | 27,351 | - | - | - | 15,557 | - |
| Other | 1,712,578 | - | 821,994 | 17,070 | 830,049 | - | 823,995 | 17,070 |

Residential

| | | | | | | | | |
|-----------|--------|---|---|---|--------|---|---|---|
| mortgages | 32,001 | - | - | - | 64,003 | - | - | - |
|-----------|--------|---|---|---|--------|---|---|---|

| | | | | | | | | |
|-------|--------------|----------|--------------|------------|--------------|-----|---------------|------------|
| Total | \$ 5,996,806 | \$ 2,289 | \$ 9,683,909 | \$ 124,667 | \$ 4,532,714 | \$- | \$ 10,465,959 | \$ 105,908 |
|-------|--------------|----------|--------------|------------|--------------|-----|---------------|------------|

The following table presents the recorded investment in non accrual and loans past due over 90 days still on accrual by class of loans as of the periods ending September 30, 2012 and December 31, 2011. This table includes Acquired loans except for those loans with evidence of credit deterioration at the time of the FOFC merger:

| | September 30, 2012 | | December 31, 2011 | |
|---|--------------------|--|-------------------|--|
| | Non-Accrual | Loans Past Due Over 90 Days Still Accruing | Non-Accrual | Loans Past Due Over 90 Days Still Accruing |
| Commercial, financial and agricultural: | | | | |
| Commercial & industrial | \$ 2,806,183 | \$ 17,281 | \$ 5,611,805 | \$ - |
| Commercial mortgages: | | | | |
| Construction | 434,338 | 4,565,392 | 18,749 | 7,295,104 |
| Other | 2,054,326 | - | 4,778,384 | - |
| Residential mortgages | 2,363,170 | - | 2,611,096 | - |
| Consumer loans | | | | |
| Credit cards | - | 11,921 | - | 9,053 |
| Home equity lines & loans | 473,981 | - | 455,418 | - |
| Indirect consumer loans | 501,745 | - | 113,349 | - |
| Other direct consumer loans | 31,316 | - | 22,287 | - |
| Total | \$ 8,665,059 | \$ 4,594,594 | \$ 13,611,088 | \$ 7,304,157 |

The commercial mortgages included in loans past due over 90 days still accruing at September 30, 2012 and December 31, 2011, were construction loans acquired in the FOFC acquisition, which for a variety of reasons are 90 days or more past their stated maturity dates. However, the borrowers continue to make required interest payments. Additionally, these loans carry third party credit enhancements, and based upon the strength of those credit enhancements, the Corporation has not identified these loans as purchased credit impaired loans and expects to incur no losses on these loans.

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The following tables present the aging of the recorded investment in loans past due (including non-accrual loans) by class of loans as of September 30, 2012 and December 31, 2011 and by Legacy loans and Acquired loans:

| | September 30, 2012 | | | | | | |
|---|---------------------|---------------------|-------------------------------|----------------|---|--------------------|----------------|
| | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days Past Due | Total Past Due | Loans Acquired with deteriorated credit quality | Loans Not Past Due | Total |
| Legacy Loans: | | | | | | | |
| Commercial, financial and agricultural: | | | | | | | |
| Commercial & industrial | \$ 7,353 | \$ - | \$ 189,912 | \$ 197,265 | \$ - | \$ 114,455,637 | \$ 114,652,902 |
| Agricultural | - | - | - | - | - | 533,841 | 533,841 |
| Commercial mortgages: | | | | | | | |
| Construction | - | - | 10,454 | 10,454 | - | 30,653,785 | 30,664,239 |
| Other | 59,389 | 73,584 | 305,495 | 438,468 | - | 205,242,958 | 205,681,426 |
| Residential mortgages | 1,571,579 | 428,641 | 622,623 | 2,622,843 | - | 176,983,403 | 179,606,246 |
| Consumer loans: | | | | | | | |
| Credit cards | 10,399 | 3,629 | 11,921 | 25,949 | - | 1,753,893 | 1,779,842 |
| Home equity lines & loans | 196,670 | 272,940 | 198,814 | 668,424 | - | 79,586,618 | 80,255,042 |
| Indirect consumer loans | 656,927 | 127,026 | 414,905 | 1,198,858 | - | 130,130,094 | 131,328,952 |
| Other direct consumer loans | 19,295 | 14,865 | 23,221 | 57,381 | - | 20,489,982 | 20,547,363 |
| Total | \$2,521,612 | \$920,685 | \$1,777,345 | \$5,219,642 | \$ - | \$759,830,211 | \$765,049,853 |

| | September 30, 2012 | | | | | | |
|---|---------------------|---------------------|-------------------------------|----------------|---|--------------------|---------------|
| | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days Past Due | Total Past Due | Loans Acquired with deteriorated credit quality | Loans Not Past Due | Total |
| Acquired Loans: | | | | | | | |
| Commercial, financial and agricultural: | | | | | | | |
| Commercial & industrial | \$ 95,799 | \$ 4,994 | \$ 361,159 | \$ 461,952 | \$ 1,152,448 | \$ 18,760,978 | \$ 20,375,378 |
| Commercial mortgages: | | | | | | | |
| Construction | - | - | 4,989,277 | 4,989,277 | 1,179,177 | 1,728,428 | 7,896,882 |

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| | | | | | | | |
|-----------------------------|-------------|---------|-------------|-------------|--------------|--------------|---------------|
| Other | 547,737 | - | 286,997 | 834,734 | 10,221,803 | 54,897,378 | 65,953,915 |
| Residential mortgages | 614,844 | - | 201,442 | 816,286 | 239,911 | 12,923,490 | 13,979,687 |
| Consumer loans: | | | | | | | |
| Home equity lines & loans | - | - | - | - | - | 5,470,998 | 5,470,998 |
| Other direct consumer loans | - | - | - | - | - | 92,309 | 92,309 |
| Total | \$1,258,380 | \$4,994 | \$5,838,875 | \$7,102,249 | \$12,793,339 | \$93,873,581 | \$113,769,169 |

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| | December 31, 2011 | | | | | | |
|--|------------------------|---------------------------|--|-------------------|--|-----------------------|----------------|
| | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days Past Due | Total Past Due | Loans Acquired with deteriorated credit quality | Loans Not Past Due | Total |
| Legacy Loans: Commercial, financial and agricultural: | | | | | | | |
| Commercial & industrial | \$ 4,571 | \$ 10,940 | \$ 2,920,906 | \$ 2,936,417 | \$ - | \$ 113,612,941 | \$ 116,549,358 |
| Agricultural | - | - | - | - | - | 258,098 | 258,098 |
| Commercial mortgages: | | | | | | | |
| Construction | - | - | - | - | - | 7,383,731 | 7,383,731 |
| Other | 82,986 | - | 2,977,010 | 3,059,996 | - | 163,818,595 | 166,878,591 |
| Residential mortgages | 1,418,234 | 293,337 | 1,221,056 | 2,932,627 | - | 172,652,660 | 175,585,287 |
| Consumer loans: | | | | | | | |
| Credit cards | 3,660 | 8,031 | 9,053 | 20,744 | - | 1,934,471 | 1,955,215 |
| Home equity lines & loans | 368,556 | 27,717 | 212,573 | 608,846 | - | 76,280,502 | 76,889,348 |
| Indirect consumer loans | 597,180 | 75,817 | 85,763 | 758,760 | - | 96,781,480 | 97,540,240 |
| Other direct consumer loans | 21,876 | 10,243 | 9,644 | 41,763 | - | 14,478,064 | 14,519,827 |
| Total | \$2,497,063 | \$426,085 | \$7,436,005 | \$10,359,153 | \$ - | \$647,200,542 | \$657,559,695 |

| | December 31, 2011 | | | | | | |
|---|---------------------------|---------------------------|--|-------------------|--|-----------------------|---------------|
| | 30-59 Days Past Due | 60-89 Days Past Due | Greater than 90 Days Past Due | Total Past Due | Loans Acquired with deteriorated credit quality | Loans Not Past Due | Total |
| Acquired Loans: Commercial, financial and agricultural: | | | | | | | |
| Commercial & industrial | \$275,121 | \$ 82,677 | \$ 195,687 | \$ 553,485 | \$ 1,499,141 | \$ 25,335,874 | \$ 27,388,500 |
| Commercial mortgages: | | | | | | | |
| Construction | - | 418,518 | 7,295,104 | 7,713,622 | 2,022,149 | 2,715,270 | 12,451,041 |

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| | | | | | | | |
|-----------------------------|-----------|-----------|-------------|-------------|---------------|---------------|----------------|
| Other | - | - | 193,570 | 193,570 | 11,063,483 | 65,836,938 | 77,093,991 |
| Residential mortgages | 405,087 | 62,017 | 84,083 | 551,187 | 226,937 | 17,753,898 | 18,532,022 |
| Consumer loans: | | | | | | | |
| Home equity lines & loans | - | - | - | - | - | 6,168,831 | 6,168,831 |
| Other direct consumer loans | 171 | - | - | 171 | - | 147,439 | 147,610 |
| Total | \$680,379 | \$563,212 | \$7,768,444 | \$9,012,035 | \$ 14,811,710 | \$117,958,250 | \$ 141,781,995 |

Troubled Debt Restructurings:

The Corporation has no allocated specific reserves to customers whose loan terms have been modified in troubled debt restructurings included in non-accrual loans as of September 30, 2012. The Corporation had \$217,866 allocated specific reserves to customers whose loan terms have been modified in troubled debt restructurings which are included in non-accrual loans as of December 31, 2011. The Corporation has not committed to lend any additional amounts as of September 30, 2012 or December 31, 2011 to customers with outstanding loans that are classified as trouble debt restructurings.

During the nine months ended September 30, 2012, two loans in the aggregate amount of \$133,661 were modified as troubled debt restructurings by the Corporation. One of these loans totaling \$58,823 was paid off during the second quarter of 2012. The modifications of the terms of these loans included an extension of a maturity date and the postponement of scheduled amortized payments for greater than a three month period. During the three months ended September 30, 2012, one loan with a principal balance of \$74,838 was modified as a troubled debt restructuring by the Corporation. Additionally, there were no payment defaults on any loans previously modified as troubled debt restructurings 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 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 lines of credit, installment, mortgage, and home equity loans, 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 as 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.

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Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be not rated loans. Based on the analysis's performed as of September 30, 2012 and December 31, 2011, the risk category of the recorded investment of loans by class of loans is as follows:

| Legacy Loans: Commercial, financial and agricultural: | September 30, 2012 | | | | |
|--|--------------------|----------------|--------------------|---------------|--------------|
| | Not Rated | Pass | Special Mention | Substandard | Doubtful |
| Commercial & industrial | \$ - | \$ 102,309,471 | \$ 7,723,549 | \$ 2,348,857 | \$ 2,271,025 |
| Agricultural | - | 533,841 | - | - | - |
| Commercial mortgages: | | | | | |
| Construction | - | 29,708,671 | 198,373 | 757,195 | - |
| Other | - | 189,704,790 | 10,730,594 | 4,887,276 | 358,766 |
| Residential mortgages | 177,499,107 | - | - | 2,107,139 | - |
| Consumer loans: | | | | | |
| Credit cards | 1,779,842 | - | - | - | - |
| Home equity lines & loans | 79,780,903 | - | - | 474,139 | - |
| Indirect consumer loans | 130,827,207 | - | - | 501,745 | - |
| Other direct consumer loans | 20,516,047 | - | - | 31,316 | - |
| Total | \$ 410,403,106 | \$ 322,256,773 | \$ 18,652,516 | \$ 11,107,667 | \$ 2,629,791 |

| Acquired Loans: Commercial, financial and agricultural: | September 30, 2012 | | | | | |
|---|--------------------|---------------|--|--------------------|-------------|-----------|
| | Not Rated | Pass | Loans Acquired with deteriorated credit quality | Special Mention | Substandard | Doubtful |
| Commercial & industrial | \$ - | \$ 18,341,646 | \$ 1,152,448 | \$ 520,125 | \$ 278,788 | \$ 82,371 |
| Commercial mortgages: | | | | | | |
| Construction | - | 251,220 | 1,179,177 | 5,044,630 | 1,421,855 | - |
| Other | - | 52,881,017 | 10,221,803 | 1,329,016 | 1,328,509 | 193,570 |
| Residential mortgages | 13,483,746 | - | 239,911 | - | 256,030 | - |

| | | | | | | |
|-----------------------------|---------------------|----------------------|---------------------|--------------------|--------------------|------------------|
| Consumer loans | | | | | | |
| Home equity lines & loans | 5,470,998 | - | - | - | - | - |
| Other direct consumer loans | 92,309 | - | - | - | - | - |
| Total | \$19,047,053 | \$ 71,473,883 | \$12,793,339 | \$6,893,771 | \$3,285,182 | \$275,941 |

| | December 31, 2011 | | | | | |
|---|----------------------|----------------------|---------------------|---------------------|--------------------|--|
| Legacy Loans: Commercial, financial and agricultural: | Not Rated | Pass | Special Mention | Substandard | Doubtful | |
| Commercial & industrial | \$ - | \$ 93,923,356 | \$ 14,957,683 | \$ 4,139,413 | \$ 3,528,906 | |
| Agricultural | - | 258,098 | - | - | - | |
| Commercial mortgages: | | | | | | |
| Construction | - | 6,391,614 | 208,360 | 783,757 | - | |
| Other | - | 152,435,884 | 6,503,087 | 7,423,514 | 516,106 | |
| Residential mortgages | 173,120,292 | - | - | 2,464,995 | - | |
| Consumer loans: | | | | | | |
| Credit cards | 1,955,215 | - | - | - | - | |
| Home equity lines & loans | 76,432,196 | - | - | 457,152 | - | |
| Indirect consumer loans | 97,426,891 | - | - | 113,349 | - | |
| Other direct consumer loans | 14,497,795 | - | - | 22,032 | - | |
| Total | \$363,432,389 | \$253,008,952 | \$21,669,130 | \$15,404,212 | \$4,045,012 | |

| | | December 31, 2011 | | | | |
|---|----------------------|---|----------------------|---------------------|---------------------|-------------------|
| | | Loans Acquired with deteriorated credit quality | | | | |
| Acquired Loans: | Not Rated | Pass | Special Mention | Substandard | Doubtful | |
| Commercial, financial and agricultural: | | | | | | |
| Commercial & industrial | \$ - | \$ 25,164,742 | \$ 1,499,141 | \$ 602,006 | \$ 24,635 | \$ 97,976 |
| Commercial mortgages: | | | | | | |
| Construction | - | 1,790,731 | 2,022,149 | 7,447,661 | 1,190,500 | - |
| Other | - | 62,684,708 | 11,063,483 | 475,036 | 2,677,194 | 193,570 |
| Residential mortgages | 18,158,984 | - | 226,937 | - | 146,101 | - |
| Consumer loans | | | | | | |
| Home equity lines & loans | 6,168,831 | - | - | - | - | - |
| Other direct consumer loans | 147,610 | - | - | - | - | - |
| Total | \$ 24,475,425 | \$ 89,640,181 | \$ 14,811,710 | \$ 8,524,703 | \$ 4,038,430 | \$ 291,546 |

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 tables present the recorded investment in residential and consumer loans based on payment activity as of September 30, 2012 and December 31, 2011:

| | | September 30, 2012 | | | |
|----------------|-----------------------|--------------------|---------------------------|-------------------------|-----------------------------|
| | | Consumer Loans | | | |
| | Residential Mortgages | Credit Card | Home Equity Lines & Loans | Indirect Consumer Loans | Other Direct Consumer Loans |
| Legacy Loans: | | | | | |
| Performing | \$ 177,499,107 | \$ 1,767,921 | \$ 79,781,061 | \$ 130,827,207 | \$ 20,516,047 |
| Non-Performing | 2,107,139 | 11,921 | 473,981 | 501,745 | 31,316 |
| | \$ 179,606,246 | \$ 1,779,842 | \$ 80,255,042 | \$ 131,328,952 | \$ 20,547,363 |

| | | | | | |
|-----------------|----------------------|-------------|---------------------|-------------|------------------|
| Acquired Loans: | | | | | |
| Performing | \$ 13,723,657 | \$ - | \$ 5,470,998 | \$ - | \$ 92,309 |
| Non-Performing | 256,030 | - | - | - | - |
| Total | \$ 13,979,687 | \$ - | \$ 5,470,998 | \$ - | \$ 92,309 |

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December 31, 2011

Consumer Loans

| | Residential | | Home Equity | Indirect | Other Direct |
|----------------|----------------|--------------|---------------|---------------|---------------|
| Legacy Loans: | Mortgages | Credit Card | Lines & | Consumer | Consumer |
| | | | Loans | Loans | Loans |
| Performing | \$ 173,120,292 | \$ 1,946,162 | \$ 76,432,196 | \$ 97,426,891 | \$ 14,497,878 |
| Non-Performing | 2,464,995 | 9,053 | 457,152 | 113,349 | 21,949 |
| Total | \$ 175,585,287 | \$ 1,955,215 | \$ 76,889,348 | \$ 97,540,240 | \$ 14,519,827 |

Acquired Loans:

| | | | | | |
|----------------|---------------|------|--------------|------|------------|
| Performing | \$ 18,385,921 | \$ - | \$ 6,168,831 | \$ - | \$ 147,610 |
| Non-Performing | 146,101 | - | - | - | - |
| Total | \$ 18,532,022 | \$ - | \$ 6,168,831 | \$ - | \$ 147,610 |

Acquired loans include loans acquired with deteriorated credit quality. The Corporation adjusted its estimates of future expected losses, cash flows, and renewal assumptions 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 tables below summarize the changes in total contractually required principal and interest cash payments, management's estimate of expected total cash payments and carrying value of the loans from January 1, 2012 to September 30, 2012 and from July 1, 2012 to September 30, 2012:

| Nine Months Ended September 30, 2012 | Balance at December 31, 2011 | Income Accretion | All Other Adjustments | Balance at September 30, 2012 |
|--|------------------------------------|---------------------|--------------------------|--|
| Contractually required principal and interest | \$21,260,381 | \$ - | \$(1,811,021) | \$19,449,360 |
| Contractual cash flows not expected to be collected (nonaccretable discount) | (4,662,346) | - | 776,839 | (3,885,507) |
| Cash flows expected to be collected | 16,598,035 | - | (1,034,182) | 15,563,853 |
| Interest component of expected cash flows (accretable yield) | (1,843,603) | 1,481,515 | (2,391,636) | (2,753,724) |
| Fair value of loans acquired with deteriorating credit quality | \$14,754,432 | \$1,481,515 | \$(3,425,818) | \$12,810,129 |

| Three Months Ended September 30, 2012 | Balance at June 30, 2012 | Income Accretion | All Other Adjustments | Balance at September 30, 2012 |
|--|--------------------------------|---------------------|--------------------------|--|
| Contractually required principal and interest | \$19,834,397 | \$ - | \$(385,037) | \$19,449,360 |
| Contractual cash flows not expected to be collected (nonaccretable discount) | (3,978,427) | - | 92,920 | (3,885,507) |
| Cash flows expected to be collected | 15,855,970 | - | (292,117) | 15,563,853 |
| Interest component of expected cash flows | (2,971,148) | 310,344 | (92,920) | (2,753,724) |

(accretable yield)

| | | | | |
|---|---------------|------------|--------------|---------------|
| Fair value of loans acquired with deteriorating credit quality | \$ 12,884,822 | \$ 310,344 | \$ (385,037) | \$ 12,810,129 |
|---|---------------|------------|--------------|---------------|

10. Components of Quarterly and Year-to-Date Net Periodic Benefit Costs

| | Nine Months Ended | | Three Months Ended | |
|--|--------------------------|--------------------------|--------------------------|--------------------------|
| | September 30, 2012 | September 30, 2011 | September 30, 2012 | September 30, 2011 |
| Qualified Pension | | | | |
| Service cost, benefits earned during the period | \$ 970,053 | \$ 777,402 | \$ 323,351 | \$ 259,134 |
| Interest cost on projected benefit obligation | 1,218,330 | 1,178,868 | 406,110 | 392,956 |
| Expected return on plan assets | (1,990,479) | (1,757,019) | (663,493) | (585,673) |
| Amortization of unrecognized transition obligation | - | - | - | - |
| Amortization of unrecognized prior service cost | 10,392 | 22,410 | 3,464 | 7,470 |
| Amortization of unrecognized net loss | 991,704 | 507,339 | 330,568 | 169,113 |
| Net periodic pension expense | \$ 1,200,000 | \$ 729,000 | \$ 400,000 | \$ 243,000 |
| Supplemental Pension | | | | |
| Service cost, benefits earned during the period | \$ 26,076 | \$ 22,968 | \$ 8,692 | \$ 7,656 |
| Interest cost on projected benefit obligation | 38,320 | 40,330 | 12,773 | 13,443 |
| Expected return on plan assets | - | - | - | - |
| Amortization of unrecognized prior service cost | - | - | - | - |
| Amortization of unrecognized net loss | 14,940 | 7,098 | 4,980 | 2,366 |
| Net periodic supplemental pension expense | \$ 79,336 | \$ 70,396 | \$ 26,445 | \$ 23,465 |
| Postretirement, Medical and Life | | | | |
| Service cost, benefits earned during the period | \$ 26,250 | \$ 24,750 | \$ 8,750 | \$ 8,250 |

| | | | | |
|---|----------|----------|----------|----------|
| Interest cost on projected benefit obligation | 54,000 | 56,250 | 18,000 | 18,750 |
| Expected return on plan assets | - | - | - | - |
| Amortization of unrecognized prior service cost | (72,750) | (72,750) | (24,250) | (24,250) |
| Amortization of unrecognized net gain | - | - | - | - |
| Net periodic postretirement, medical and life expense | \$ 7,500 | \$ 8,250 | \$ 2,500 | \$ 2,750 |

11. Segment Reporting

The Corporation manages its operations through two primary business segments: core banking and wealth management group services. The core banking segment provides revenues by attracting deposits from the general public and using such funds to originate consumer, commercial, commercial real estate, and residential mortgage loans, primarily in the Corporation's local markets and to invest in securities. The wealth management group services segment provides revenues by providing trust and investment advisory services to clients.

Summarized financial information concerning the Corporation's reportable segments and the reconciliation to the Corporation's consolidated results is shown in the following table. Income taxes are allocated based on the separate taxable income of each segment and indirect overhead expenses are allocated based on reasonable and equitable allocations applicable to the reportable segment. Holding company amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the "Holding Company and Other" column below, along with amounts to eliminate transactions between segments (dollars in thousands):

| | Three Months Ended September 30, 2012 | | | | Nine Months Ended September 30, 2012 | | | |
|---|---------------------------------------|----------------------------------|---------------------------|---------------------|--------------------------------------|----------------------------------|---------------------------|---------------------|
| | Core Banking | Wealth Management Group Services | Holding Company And Other | Consolidated Totals | Core Banking | Wealth Management Group Services | Holding Company And Other | Consolidated Totals |
| Net interest income | \$ 11,774 | \$ - | \$ 1 | \$ 11,775 | \$ 35,149 | \$ - | \$ 7 | \$ 35,156 |
| Provision for loan losses | 225 | - | - | 225 | 754 | - | - | 754 |
| Net interest income after provision for loan losses | 11,549 | - | 1 | 11,550 | 34,395 | - | 7 | 34,402 |
| Other operating income | 2,180 | 1,668 | 212 | 4,060 | 7,396 | 5,170 | 522 | 13,088 |
| Other operating expenses | 9,510 | 1,708 | 175 | 11,393 | 28,344 | 5,279 | 577 | 34,200 |
| Income or (loss) before income tax expense | 4,219 | (40) | 38 | 4,217 | 13,447 | (109) | (48) | 13,290 |
| Income tax | 1,400 | (15) | (2) | 1,383 | 4,512 | (42) | (72) | 4,398 |

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| | | | | | | | | | |
|------------------------------------|----------|---------|-------|----------|----------|---------|-------|----------|--|
| expense (benefit) | | | | | | | | | |
| Segment net income (loss) | \$ 2,819 | \$ (25) | \$ 40 | \$ 2,834 | \$ 8,935 | \$ (67) | \$ 24 | \$ 8,892 | |

| | | | | | | | | | |
|-------------------|--|--|--|-------------|---------|---------|-------------|--|--|
| Segment assets | | | | \$1,279,107 | \$5,249 | \$2,624 | \$1,286,980 | | |
|-------------------|--|--|--|-------------|---------|---------|-------------|--|--|

| | Three Months Ended September 30, 2011 | | | | Nine Months Ended September 30, 2011 | | | |
|--|---------------------------------------|---|------------------------------------|------------------------|--------------------------------------|---|------------------------------------|------------------------|
| | Core Banking | Wealth Management Group Services | Holding Company And Other | Consolidated Totals | Core Banking | Wealth Management Group Services | Holding Company And Other | Consolidated Totals |
| Net interest income | \$ 11,842 | \$ - | \$ 1 | \$ 11,843 | \$ 31,834 | \$ - | \$ 6 | \$ 31,840 |
| Provision for loan losses | 583 | - | - | 583 | 833 | - | - | 833 |
| Net interest income after provision for loan losses | 11,259 | - | 1 | 11,260 | 31,001 | - | 6 | 31,007 |
| Other operating income | 2,465 | 1,747 | 116 | 4,328 | 7,284 | 5,131 | 1,005 | 13,420 |
| Other operating expenses | 8,638 | 1,843 | 136 | 10,617 | 27,259 | 5,450 | 553 | 33,262 |
| Income or (loss) before income tax expense | 5,086 | (96) | (19) | 4,971 | 11,026 | (319) | 458 | 11,165 |
| Income tax expense (benefit) | 1,742 | (37) | (25) | 1,680 | 3,589 | (123) | 123 | 3,589 |
| Segment net income (loss) | \$ 3,344 | \$ (59) | \$ 6 | \$ 3,291 | \$ 7,437 | \$ (196) | \$ 335 | \$ 7,576 |
| Segment assets | | | | \$1,257,067 | \$5,856 | \$3,001 | \$1,265,924 | |

12. Stock Based Compensation

Board of Director's Stock Compensation

Members of the Board of Directors receive common shares of the Corporation equal in value to the amount of fees individually earned during the previous year for service as a director. The common shares are distributed to the Corporation's individual board members from treasury shares of the Corporation on or about January 15 following the calendar year of service.

Additionally, the President and Chief Executive Officer of the Corporation, who does not receive cash compensation as a member of the Board of Directors, is awarded common shares equal in value to the average of those awarded to board members not employed by the Corporation who have served for 12 months during the prior year.

During January 2012, 10,238 shares were re-issued from treasury to fund the stock component of directors' compensation. An expense of \$156,863 related to this compensation was recognized during the period ending September 30, 2012. This expense is accrued as shares are earned.

Restricted Stock Plan

Pursuant to the Corporation's Restricted Stock Plan (the "Plan"), the Corporation may make discretionary grants of restricted stock to officers other than the Corporation's Chief Executive Officer. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at issue date. The maximum number of shares as to which stock awards may be granted under the Plan is 10,000 per year, with these shares vesting over a five year period.

A summary of restricted stock activity from December 31, 2011 to September 30, 2012 is presented below:

| | Shares | Weighted -Average Grant Date Fair Value |
|---------------------------------|--------|---|
| Nonvested at December 31, 2011 | 12,458 | \$ 22.33 |
| Granted | 2,095 | 23.87 |
| Vested | (824) | 22.59 |
| Forfeited or Cancelled | - | - |
| Nonvested at September 30, 2012 | 13,729 | \$ 22.55 |

As of September 30, 2012, there was \$262,866 of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 3.97 years.

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

The review that follows focuses on the significant factors affecting the financial condition and results of operations of the Corporation during the three and nine-month periods ended September 30, 2012, with comparisons to the comparable periods in 2011, as applicable. The following discussion and the unaudited consolidated interim financial statements and related notes included in this report should be read in conjunction with our 2011 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 28, 2012. The results for the periods presented are not necessarily indicative of results to be expected for the entire fiscal year or any other interim period.

Forward-looking Statements

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. Statements regarding, among other things, the Corporation's expected financial position and operating results, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," or "intend." The Corporation cannot promise that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions or interest rates, credit risk, difficulties in managing our growth, competition, changes in law or the regulatory environment, including as a result of regulations or rules promulgated pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, and changes in general business and economic trends. Information concerning risks facing the Corporation can be found in our periodic filings with the Securities and Exchange Commission, including in our 2011 Annual Report on Form 10-K. These filings are available publicly on the SEC's website at <http://www.sec.gov>, on the Corporation's website at <http://www.chemungcanal.com> or upon request from the Corporate Secretary at (607) 737-3746. Except as otherwise required by law, the Corporation undertakes no obligation to publicly update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

Critical Accounting Policies, Estimates and Risks and Uncertainties

Critical accounting policies include the areas where the Corporation has made what it considers to be particularly difficult, subjective or complex judgments concerning estimates, and where these estimates can significantly affect the Corporation's financial results under different assumptions and conditions. The Corporation prepares its financial statements in conformity with accounting principles generally accepted in the United States of America. As a result, the Corporation is required to make certain estimates, judgments and assumptions that it believes are reasonable based upon the information available at that time. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

Allowance for Loan Losses

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover probable incurred credit losses inherent in the loan portfolio, and the material effect that such judgments can have on the Corporation's results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is adequate, under adversely different conditions or assumptions the allowance would need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provisions for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Corporation's non-performing loans and potential problem loans, and the associated evaluation of the related collateral coverage for these loans, has a significant impact on the overall analysis of the adequacy of the allowance for loan losses. Real estate values in the Corporation's market area did not increase dramatically in the prior several years, and, as a result, any declines in real estate values have been modest. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral evaluations were significantly lowered, the Corporation's allowance for loan losses policy would also require additional provisions for loan losses.

Other-Than-Temporary Impairment

Management also considers the accounting policy relating to other-than-temporary impairment ("OTTI") of investment securities to be a critical accounting policy. The determination of whether a decline in market value is other-than-temporary is necessarily a matter of subjective judgment. The timing and amount of any realized losses reported in the Corporation's financial statements could vary if management's conclusions were to change as to whether other-than-temporary impairment exists. The Corporation assesses whether it intends to sell, or it is more likely than not that it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized through a charge to earnings. For those securities that do not meet the aforementioned criteria, such as those that management has determined to be other-than-temporarily impaired, the amount of impairment charged to earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in other comprehensive income. For the three and nine-month periods ended September 30, 2012, the Corporation recognized no OTTI charges.

Goodwill and Other Intangible Assets

Management also considers the accounting policy relating to the valuation of goodwill and other intangible assets to be a critical accounting policy. The initial carrying value of goodwill and other intangible assets is determined using estimated fair values developed from various sources and other generally accepted valuation techniques. Estimates are based upon financial, economic, market and other conditions as they existed as of the date of a particular acquisition. These estimates of fair value are the results of judgments made by the Corporation based upon estimates that are inherently uncertain and changes in the assumptions upon which the estimates were based may have a significant impact on the resulting estimates. In addition to the initial determination of the carrying value, on an ongoing basis management must assess whether there is any impairment of goodwill and other intangible assets that would require an adjustment in carrying value and recognition of a loss in the consolidated statement of income.

Financial Condition

Consolidated assets at September 30, 2012 totaled \$1.287 billion, an increase of \$70.7 million, or 5.8%, since December 31, 2011. The growth was primarily due to increases of \$79.4 million, or 10.0%, in total portfolio loans and \$28.3 million in cash and cash equivalents, partially offset by a decrease of \$29.4 million in investment securities. Total liabilities increased \$63.8 million to \$1.154 billion at September 30, 2012, compared with December 31, 2011, primarily due to an increase of \$84.7 million in deposits, partially offset by a decrease of \$19.5 million in borrowings. Total equity was \$132.9 million at September 30, 2012, an increase of \$7.0 million from December 31, 2011, primarily due to the Corporation's net income of \$8.9 million for the nine months ended September 30, 2012.

Loans

The composition of the loan portfolio is summarized as follows:

| | September 30, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Commercial, financial and agricultural | \$ 133,365,046 | \$ 142,209,279 |
| Commercial mortgages | 311,126,130 | 264,589,013 |
| Residential mortgages | 193,049,212 | 193,599,853 |
| Indirect Consumer loans | 130,969,296 | 97,165,447 |
| Consumer loans | 107,848,451 | 99,351,585 |
| Total loans, net of deferred origination fees and cost, and unearned income | \$ 876,358,135 | \$ 796,915,177 |

The increase in portfolio loans was due to strong growth of \$42.3 million, or 21.5%, in consumer loans and \$37.7 million, or 9.3%, in commercial loans. The growth in consumer loans was primarily due to increases of \$33.8 million in indirect consumer loans and \$5.2 million in direct consumer installment loans and \$2.7 million in home equity loans. During the second quarter of 2012, the Corporation implemented an indirect consumer loan program with reduced pricing on high quality indirect auto loans in an effort to put excess liquidity to better use. In addition, the Corporation implemented a marketing campaign for direct consumer loans during the second quarter of 2012. The growth in commercial loans was primarily due to an increase of \$33.9 million in commercial loans in the Capital Bank (as defined herein) division in the Albany, New York region, which was the former market area of Fort Orange Financial Corp ("FOFC"), which was acquired in April 2011.

For the nine months ended September 30, 2012, \$8.7 million of newly originated residential mortgages were sold in the secondary market to Freddie Mac, with an additional \$0.6 million originated and sold to the State of New York Mortgage Agency.

Securities

The available-for-sale segment of the securities portfolio totaled \$253.7 million at September 30, 2012, a decrease of \$27.2 million, or 9.7%, from December 31, 2011. The decrease resulted from sales and calls of \$70.4 million, maturities of \$4.1 million and principal paydowns of \$17.3 million. These items were partially offset by purchases of \$64.3 million. Sales and calls of securities included a \$25.4 million U.S. Treasury bond, \$43.0 million in federal agency bonds and \$2.0 million in municipal bonds. All of the maturities were in municipal bonds. Principal paydowns were primarily in mortgage-backed securities and collateralized mortgage obligations. Purchases included a \$27.5 million U.S. Treasury bond, \$35.0 million in federal agency bonds and \$1.8 million in municipal bonds.

The held-to-maturity segment of the securities portfolio, consisting of local municipal obligations, totaled \$6.2 million at September 30, 2012, a decrease of \$2.1 million from December 31, 2011.

Cash and Cash Equivalents

As noted above, cash and cash equivalents increased \$28.3 million since December 31, 2011, primarily due to a \$21.2 million increase in interest-bearing deposits at other financial institutions. The increase in interest-bearing deposits at other financial institutions was a result of the significant increase in deposits and a decrease in the securities portfolio, partially offset by the growth in the loan portfolio and the payoff of borrowings. Additionally, cash and due from financial institutions increased \$7.1 million due to an \$8.1 million increase in the volume of items in process of clearing through the Federal Reserve Bank and JP Morgan Chase, offset by a \$1.0 million decrease in branch cash levels. With total cash and due from banks totaling \$81.2 million at September 30, 2012, the Corporation continues to maintain a strong liquidity position and evaluate alternative investment of these funds with caution given the historically low interest rate environment and the inherent interest rate risk associated with longer term securities portfolio investments.

Other Assets

A \$5.7 million decrease in other assets was due principally to a \$4.0 million decrease in the over payment of 2011 estimated income taxes and a \$1.9 million decrease in net deferred tax assets.

Deposits

Since December 31, 2011, total deposits increased \$84.7 million, or 8.5%, to \$1.083 billion, with public fund balances increasing \$44.8 million and all other deposits increasing \$39.9 million. The increase in public fund deposits was primarily due to increases in NOW account and insured money market account ("IMMA") balances totaling \$25.0 million and \$11.5 million, respectively, as well as a \$7.4 million increase in demand deposits. The increase in all other period-end deposits reflects a \$59.2 million increase in IMMA balances, as well as increases in demand deposits and NOW accounts totaling \$36.3 million and \$9.6 million, respectively. These increases were partially offset by a \$37.2 million decrease in savings balances and a \$28.0 million decrease in certificates of deposit. Both the decrease in savings balances and the increase in IMMA accounts were impacted by an initiative to convert funds from the former Capital Bank tiered interest rate savings accounts into the Capital Bank Privilege IMMA account.

Other Borrowings

Both a \$15.3 million decrease in Federal Home Loan Bank of New York ("FHLB") term advances and a \$4.2 million decrease in securities sold under agreements to repurchase reflect the maturity of obligations during the nine months ended September 30, 2012.

Shareholders' Equity

Since December 31, 2011, shareholders' equity increased \$7.0 million, or 5.5%, primarily due to net income of \$8.9 million for the nine months ended September 30, 2012 and a \$1.4 million increase in accumulated other comprehensive income, partially offset by cash dividends of \$3.4 million.

Asset Quality

Non-Performing Loans

The recorded investment in non-performing loans at September 30, 2012, totaled \$13.3 million compared to \$20.9 million at year-end 2011, a decrease of \$7.6 million. Not included in the non-performing loan totals are loans acquired in the April 2011 acquisition of FOFC and its wholly owned subsidiary, Capital Bank & Trust Company ("Capital Bank"), which the Corporation has identified as purchased credit impaired ("PCI") loans totaling \$12.8 million at September 30, 2012, which are accounted for under separate accounting guidance, Accounting Standards Codification ("ASC") Subtopic 310-30, "Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality" as disclosed in Note 9 of the financial statements. The decrease in non-performing loans was due to decreases in non-accrual loans and loans 90 days or more past due totaling \$4.9 million and \$2.7 million, respectively. The decrease in non-accrual loans was primarily due to a \$5.2 million reduction in non-accrual commercial loans to one borrower. Included in the \$5.2 million reduction were \$5.1 million of funds received from United States Department of Agriculture ("USDA") guarantees. Other non-accrual commercial loans increased slightly from December 31, 2011 to September 30, 2012. Additionally, during the nine months ended September 30, 2012, non-accrual residential mortgages decreased \$0.2 million, while non-accrual consumer loans increased \$0.4 million. It is generally the Corporation's policy that a loan 90 days past due be placed in non-accrual status unless factors exist that would eliminate the need to place a loan in this status. A loan may also be designated as non-accrual at any time if payment of principal or interest in full is not expected due to deterioration in the financial condition of the borrower. Loans remain in non-accrual status until the loans have been brought current and remain current for a period of six months. In the case of non-accrual loans where a portion of the loan has been charged off, the remaining balance is kept in non-accrual status until the entire principal balance has been recovered.

The recorded investment in accruing loans 90 days or more past due totaled \$4.6 million at September 30, 2012, compared with \$7.3 million at year-end 2011, a decrease of \$2.7 million. This decrease was primarily due to a \$2.7 million decrease in construction loans not considered by management to be PCI loans acquired in the FOFC acquisition, which for a variety of reasons are 90 days or more past their stated maturity dates. These loans totaled \$4.6 million at September 30, 2012. However, the borrowers continue to make required interest payments. Additionally, these loans carry third party credit enhancements, and based upon the strength of those credit enhancements, the Corporation has not identified these loans as PCI loans and expects to incur no losses on these loans.

At September 30, 2012, there was no change to other real estate owned ("OREO") compared with December 31, 2011, as it remained at \$0.9 million. During the nine months ended September 30, 2012, seven properties totaling \$0.5 million were placed in OREO and seven properties totaling \$0.4 million were sold. Additionally, the Corporation recognized a write-down on one property totaling \$0.1 million following the acceptance of a purchase offer on this property.

Impaired Loans

Impaired loans at September 30, 2012, totaled \$4.4 million compared to \$10.1 million at December 31, 2011. Not included in the impaired loan totals are loans acquired in the FOFC acquisition which the Corporation has identified as PCI loans, as these loans are accounted for under ASC Subtopic 310-30 as noted under the above discussion of non-performing loans. The decrease of \$5.7 million in impaired loans was primarily due to a \$5.2 million reduction in non-accrual commercial loans to one borrower. Included in the \$5.2 million reduction were \$5.1 million of funds received from USDA guarantees. Included in the impaired loan total at September 30, 2012, are loans totaling \$2.8 million for which impairment allowances of \$1.0 million have been specifically allocated to the allowance for loan losses. As of December 31, 2011, the impaired loan total included \$6.1 million of loans for which specific impairment allowances of \$1.9 million were allocated to the allowance for loan losses. The decrease in the amount of impaired loans for which specific allowances were allocated to the allowance for loan losses was due in large part to the above mentioned receipt of funds under USDA guarantees. The reduction in specific impairment allowances allocated to the allowance for loan losses was also related to the above mentioned receipt of funds as well as improvement in the collateral position on an impaired loan. The majority of the Corporation's impaired loans are secured and measured for impairment based on collateral evaluations. It is the Corporation's policy to obtain updated appraisals on loans secured by real estate at the time a loan is determined to be impaired. Prior to the receipt of the updated appraisal, an impairment measurement is performed based upon the most recent appraisal on file to determine the amount of any specific allocation or charge-off. Upon receipt and review of the updated appraisal, an additional measurement is performed to determine if any adjustments are necessary to reflect the proper provisioning or charge-off. Impaired loans are reviewed on a quarterly basis to determine if any changes in credit quality or market conditions would require any additional allocation or recognition of additional charge-offs. If market conditions warrant, future appraisals are obtained. Real estate values in the Corporation's market area had not increased dramatically in the prior several years, and, as a result, declines in real estate values have been modest.

Appraisals are performed by independent third parties and reflect the properties market value "as is". In determining the amount of any specific allocation or charge-off, the Corporation will make adjustments to reflect the estimated costs to sell the property. In situations where partial charge-offs have been recognized, any balance remaining continues to be reflected as non-performing until the loan has been paid in full. 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.

The following table summarizes the Corporation's recorded investment in non-performing assets:

| | September 30, 2012 | December 31, 2011 |
|---|-----------------------|----------------------|
| Non-accrual loans | \$ 8,665,059 | \$ 13,611,088 |
| Accruing loans past due 90 days or more | 4,594,392 | 7,304,157 |
| Total non-performing loans | \$ 13,259,451 | \$ 20,915,245 |

| | | |
|-----------------------------------|---------------|---------------|
| Other real estate owned | 933,826 | 897,755 |
| Total non-performing assets | \$ 14,193,277 | \$ 21,813,000 |

In addition to non-performing loans, as of September 30, 2012, the Corporation has identified commercial relationships totaling \$7.3 million as potential problem loans, as compared to \$8.2 million at December 31, 2011. Potential problem loans are loans that are currently performing, but known information about possible credit problems of the related borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms, which may result in the disclosure of such loans as non-performing at some time in the future. Potential problem loans are typically loans that are performing but are classified in the Corporation's loan rating system as "substandard." Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on non-accrual status, be restructured, or require increased allowance coverage and provisions for loan losses.

Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as historical loan loss experience, review of specific problem loans (including evaluation of the underlying collateral), changes in the composition and volume of the loan portfolio, recent charge-off experience, overall portfolio quality, current economic conditions that may affect the borrowers' ability to pay and, as of the first quarter of 2012, global and national fiscal uncertainties, including their potential effects on our borrowers.

For the three months ended September 30, 2012, the provision for loan loss expense totaled \$0.2 million compared with \$0.6 million for the same period in 2011, a decrease of \$0.4 million. This decrease was due principally to the improvement in the volume of non-performing and impaired loans, resulting in a reduction in allocations to the allowance for loan losses related to these loans, which was offset in part by loan portfolio growth and allowances for this growth after consideration of the factors discussed above. For the nine months ended September 30, 2012 and September 30, 2011, the provision for loan loss expense totaled \$0.8 million.

During the third quarter of this year, the Corporation recorded net recoveries of \$0.2 million compared with net charge-offs of \$0.7 million during the third quarter of the prior year. This improvement was primarily due to lower commercial loan charge-offs in the current quarter compared with the same quarter in the prior year. The prior year quarter had one large commercial loan charge-off for \$0.6 million. In addition, consumer loan charge-offs declined in the current quarter compared with the same quarter in the prior year. For the nine months ended September 30, 2012, net recoveries totaled \$0.3 million compared with net charge-offs of \$0.7 million for the same period in the prior year. This improvement was primarily in commercial loans as net recoveries were \$0.5 million for the nine months ended September 30, 2012, compared with net charge-offs of \$0.3 million for the same period in the prior year. In addition, consumer loan net charge-offs declined by \$0.2 million for the current year compared with the prior year. At September 30, 2012, the Corporation's allowance for loan losses on Legacy loans (which are defined as total loans excluding loans acquired in the FOFC acquisition) totaled \$10.5 million, resulting in a coverage ratio of allowance to non-performing loans of 79.4%. This ratio, as well as the ratio of allowance to total loans, was impacted by the April 2011 FOFC acquisition, as current accounting rules do not allow the acquiror to transfer the acquiree's allowance for loan losses to the acquiror's balance sheet. Rather, the acquiree's overall loan quality is a component in determining the fair value of loans acquired, which are carried on the balance sheet at fair value. The ratio of the allowance for loan losses to total loans was 1.24% at September 30, 2012. Excluding loans acquired in the FOFC acquisition, the allowance for loan losses on Legacy loans to total Legacy loans was 1.38% and represents an amount that management believes is adequate to absorb probable incurred loan losses on the Corporation's Legacy loan portfolio.

The allocated portions of the allowance reflect management's estimates of specific known risk elements in the respective portfolios. Management's methodology followed in evaluating the allowance for loan losses includes a detailed analysis of historical loss factors for pools of similarly graded loans, as well as specific collateral reviews of relationships graded special mention, substandard or doubtful with outstanding balances of \$1.0 million or greater. Among the factors considered in allocating portions of the allowance by loan type are the current levels of past due, non-accrual and impaired loans, as well as historical loss experience and the evaluation of collateral. In addition, management has formally documented factors considered in determining the appropriate level of general reserves, including current economic conditions, forecasted trends in the credit quality cycle, loan growth, entry into new markets, and industry and peer group trends. These amounts have been included in the allocated portion of the loan categories to which they relate.

At September 30, 2012, in addition to the qualitative factors allocated within the allowance, the Corporation maintained \$0.5 million of the allowance as unallocated. While some improvements have been seen in the local economy and some loans have improved, the recovery is still fragile and management believes it is prudent to see a longer period of sustained improvement before completely reflecting this in the allowance. Additionally, management monitors coverage ratios of nonperforming loans and total loans compared to peers on a regular basis. This analysis also suggests that it would be prudent to maintain the unallocated portion of the allowance at this time.

Activity in the allowance for loan losses was as follows:

| | Nine Months Ended September 30, 2012 | |
|--|---|-------------------|
| | Legacy Loans | Acquired Loans |
| Balance at beginning of period | \$ 9,659,320 | \$ - |
| Reclassification of acquired loan discount | - | 123,599 |
| Charge-offs: | | |
| Commercial, financial and agricultural | (5,792) | - |
| Commercial mortgages | (39,314) | (49,057) |
| Residential mortgages | (82,442) | - |
| Consumer loans | (342,867) | - |
| Total | (470,415) | (49,057) |
| Recoveries: | | |
| Commercial, financial and agricultural | 591,497 | - |
| Commercial mortgages | 43,031 | - |
| Residential mortgages | - | - |
| Consumer loans | 176,139 | - |
| Total | 810,667 | - |
| Net recoveries (charge-offs) | 340,252 | (49,057) |
| Provision charged to operations | 533,000 | 220,897 |
| Balance at end of period | \$ 10,532,572 | \$ 295,399 |

Nine Months
Ended
September 30,
2011

| | |
|--------------------------------|----------|
| Balance at beginning of period | \$ 9,498 |
|--------------------------------|----------|

Charge-offs:

| | |
|--|---------|
| Commercial, financial and agricultural | (594) |
| Commercial mortgages | (4) |
| Residential mortgages | (39) |
| Consumer loans | (543) |
| Total | (1,180) |

Recoveries:

| | |
|--|----------|
| Commercial, financial and agricultural | 315 |
| Commercial mortgages | 33 |
| Residential mortgages | 30 |
| Consumer loans | 148 |
| Total | 526 |
| Net recoveries (charge-offs) | (654) |
| Provision charged to operations | 833 |
| Balance at end of period | \$ 9,677 |

Results of Operations

Third Quarter of 2012 vs. Third Quarter of 2011

Net income for the third quarter of 2012 totaled \$2.8 million, a decrease of \$0.5 million, or 13.9%, compared with third quarter 2011 net income of \$3.3 million. Earnings per share for the current quarter totaled \$0.61 compared with \$0.71 for the same period in the prior year. The decline was attributable to an increase of \$0.8 million in non-interest expense and a reduction of \$0.4 million in net gain on securities transactions. These items were partially offset by reductions of \$0.4 million in the provision for loan loss expense and \$0.3 million in income taxes. Return on average assets and return on average equity for the current quarter were 0.89% and 8.53%, respectively, compared with 1.05% and 10.18%, respectively, for the third quarter of 2011.

Net interest income, which is the difference between the income we make on interest-earning assets and the expense we incur on interest-bearing liabilities, is the largest component of the Corporation's net income. Net interest income for the third quarter of 2012 decreased slightly compared with the third quarter of 2011, and the net interest margin decreased seven basis points to 4.04%. The decrease in net interest income and margin was due to a 26 basis point decrease in the yield on average earning assets, partially offset by a 21 basis point decrease in the cost of average interest-bearing liabilities. Average earning assets increased \$17.7 million, or 1.5%, as an \$82.8 million increase in average loans was partially offset by decreases in average interest bearing deposits at other financial institutions and average investment securities totaling \$43.6 million and \$21.5 million, respectively. While average earning assets increased 1.5%, total interest and dividend income decreased \$0.6 million, or 4.3%, as the yield on average earning assets decreased 26 basis points to 4.46%.

Total average funding liabilities for the third quarter of 2012, including non-interest bearing demand deposits, totaled \$1.121 billion, an increase of \$11.8 million, or 1.1%, compared with the third quarter of last year. The increase in average funding liabilities was primarily due to an increase of \$33.2 million in average deposits, partially offset by a decrease of \$21.5 million in average borrowings. Average non-interest-bearing deposits increased \$38.7 million, while total average interest-bearing deposits were down \$5.4 million. The decrease in average interest-bearing deposits was due to a \$61.5 million decrease in average time deposits and a \$34.4 million decrease in average savings accounts. These decreases were partially offset by a \$78.4 million increase in average IMMA accounts and a \$12.0 million increase in average NOW accounts. The decrease in average borrowings was primarily due to decreases in average securities sold under agreements to repurchase and average FHLB term borrowings totaling \$9.9 million and \$11.6 million, respectively. While average interest-bearing liabilities decreased \$26.9 million, or 3.2%, interest expense decreased \$0.5 million or 29.1%, as the cost of average interest-bearing liabilities decreased 21 basis points to 0.60%.

For the three months ended September 30, 2012, the provision for loan loss expense totaled \$0.2 million compared with \$0.6 million for the same period in 2011, a decrease of \$0.4 million. This decrease was principally due to the improvement in the volume of non-performing and impaired loans, resulting in a reduction in allocations to the allowance for loan losses related to these loans, which was offset in part by loan portfolio growth and allowances for this growth. Management's evaluation of the adequacy of the allowance for loan losses takes into consideration several factors, including an analysis of historical loss factors, the evaluation of collateral, recent charge-off experience, overall credit quality, current economic conditions, global and national fiscal uncertainties and loan growth.

For the third quarter of 2012, non-interest income totaled \$4.1 million, a decrease of \$0.3 million, or 6.2%, compared with the third quarter of last year due primarily to a \$0.4 million decrease in net gain on securities transactions.

For the third quarter of 2012, non-interest expense totaled \$11.4 million, an increase of \$0.8 million, or 7.3%, compared with \$10.6 million for the third quarter of last year. The increase was primarily due to increases of \$0.4 million in salaries and wages, \$0.2 million in pension and other employee benefits and \$0.1 million in other real estate owned expenses. The increase in salaries and wages was primarily due to an increase in employees in the Capital Bank division and additional compensation related to merit increases and incentive compensation. The increase in pension and other employee benefits was primarily due to higher pension costs and health benefits. The increase in other real estate owned expense was due to the write-down of a commercial property.

A \$0.3 million decrease in income tax expense reflects a \$0.8 million reduction in pre-tax income, and a decrease in the effective tax rate from 33.8% to 32.8%, due primarily to an increase in the relative percentage of tax exempt income to pre-tax income.

Year-to-Date 2012 vs. Year-to-Date 2011

Net income for the nine-month period ended September 30, 2012, totaled \$8.9 million, an increase of \$1.3 million, or 17.4%, compared with \$7.6 million for the nine-month period ended September 30, 2011. The improvement was attributable to an increase of \$3.3 million in net interest income, partially offset by increases of \$0.9 million in non-interest expense and \$0.8 million in income taxes, and a reduction of \$0.3 million in non-interest income. Earnings per share for the nine months ended September 30, 2012, was \$1.92 compared with \$1.76 for the same period in the prior year. Return on average assets and return on average equity for the nine months ended September 30, 2012, were 0.95% and 9.12%, respectively, compared with 0.88% and 8.66%, respectively, for the same period in the prior year. Year-to-date net income improved significantly due primarily to an increase in net interest income and a \$2.2 million decrease in pre-tax one-time merger transaction costs, both related to the FOFC acquisition. In addition, the Corporation recognized \$0.8 million in pre-tax casualty gains from insurance reimbursements related to the September 2011 flooding of the Owego and Tioga offices.

For the nine months ended September 30, 2012, net interest income totaled \$35.2 million, an increase of \$3.3 million, or 10.4%, compared with the same period in 2011, and the net interest margin increased eight basis points to 4.10%. These increases reflect a higher level of average earning assets due in large part to the FOFC acquisition and a 20 basis point decrease in the cost of average interest-bearing liabilities, partially offset by a ten basis point decrease in the yield on average earning assets. Average earning assets increased \$88.0 million or 8.3%, as increases in average loans and investment securities totaling \$106.8 million and \$9.1 million, respectively, were partially offset by a \$27.9 million decrease in average interest-bearing deposits at other financial institutions. Included in the growth in average loans and investment securities are the Capital Bank division's assets for a full nine months in 2012 compared with six months in 2011. Due to the increase in average earning assets, total interest and dividend income increased \$2.3 million or 6.3% despite a ten basis point decrease in yield to 4.58%.

For the nine months ended September 30, 2012, total average funding liabilities, including non-interest-bearing demand deposits, increased \$83.4 million, or 8.1%, to \$1.111 billion compared with the same period in the prior year. The growth was primarily due to an increase of \$89.4 million in average deposits, partially offset by a decrease of \$6.0 million in borrowings. These increases include increases in average deposits and borrowings in the Capital Bank division of \$47.4 million and \$4.1 million, respectively. In total, average non-interest bearing deposits increased \$42.8 million, with the Capital Bank division's non-interest bearing deposits comprising \$11.8 million of that increase. Average interest-bearing deposits increased \$46.6 million, including a \$35.6 million increase in average interest-bearing deposits in the Capital Bank's division. The increase in average interest-bearing deposits was reflected principally in a \$60.9 million increase in average IMMA balances, a \$3.1 million increase in average savings balances and a \$16.1 million increase in average NOW accounts. These increases were partially offset by a \$33.5 million decrease in average time deposits. While average interest-bearing liabilities increased \$40.6 million or 5.1%, interest expense decreased \$1.0 million or 19.4%, as the average cost of interest-bearing liabilities decreased 20 basis points to 0.67%.

For the nine months ended September 30, 2012, the provision for loan loss expense totaled \$0.8 million, level with the prior year.

Year-to-date non-interest income for 2012 was \$13.1 million compared with \$13.4 million for the same period in the prior year, a decrease of \$0.3 million, or 2.5%. The decline was primarily due to decreases of \$0.8 million in net gain on securities transactions and \$0.5 million in revenue from our equity investment in Cephass Capital Partners, L.P. ("Cephass"). The decrease in revenue from our equity investment in Cephass was due in large part to a gain recognized during the first quarter of last year on the exercise of stock warrants held in one of their investments. These items were partially offset by \$0.8 million in casualty gains from insurance reimbursements related to the September 2011 flooding of the Owego and Tioga offices and an increase in net gain on sale of loans held for sale.

Year-to-date non-interest expense for 2012 was \$34.2 million compared with \$33.3 million for the same period in the prior year, an increase of \$0.9 million, or 2.8%. Excluding \$2.2 million in merger related expenses from the prior year, non-interest expense increased \$3.2 million, or 10.2% for the nine months ended September 30, 2012. This increase was primarily due to increases of \$1.2 million in salaries and wages, \$0.8 million in pension and other employee benefits, \$0.4 million in data processing expenses and \$0.2 million in other real estate owned expenses. The increase in salaries and wages was primarily due to the operation of the Capital Bank division for nine months during 2012 compared with six months during 2011, and additional compensation related to merit increases and incentive compensation. The increase in pension and other employee benefits was primarily due to higher pension costs, health benefits and payroll taxes. The increase in data processing expenses was primarily due to higher hardware and software maintenance fees and check card processing costs that included conversion costs for a new processor.

A \$0.8 million increase in income tax expense reflects a \$2.1 million increase in pre-tax income, and an increase in the effective tax rate to 33.1% from 32.2%, due primarily to a decrease in the relative percentage of tax exempt income to pre-tax income.

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Average Consolidated Balance Sheet and Interest Analysis

For the purpose of the table below, non-accruing loans are included in the daily average loan amounts outstanding.

Daily balances were used for average balance

computations. Investment securities are stated at amortized cost. No tax equivalent adjustments have been made in

calculating yields on obligations of states and

political subdivisions. (dollars in thousands)

| | Nine Months Ended September 30, 2012 | | | Nine Months Ended September 30, 2011 | | | Three Months Ended September 30, 2012 | | | Thre Sep |
|--|---|---------------|----------------|---|---------------|----------------|--|---------------|----------------|------------------|
| | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate | Average Balance | Interest | Yield/ Rate | Avera Balanc |
| Assets | | | | | | | | | | |
| Earning assets: | | | | | | | | | | |
| Loans | \$ 829,396 | \$ 34,078 | 5.49% | \$ 722,583 | \$ 31,456 | 5.82% | \$ 867,972 | \$ 11,374 | 5.21% | \$ 785, |
| Taxable securities | 219,985 | 4,142 | 2.52% | 208,891 | 4,348 | 2.78% | 208,000 | 1,306 | 2.50% | 223, |
| Tax-exempt securities | 49,796 | 977 | 2.62% | 51,813 | 1,035 | 2.67% | 46,811 | 300 | 2.55% | 53, |
| Interest-bearing deposits | 47,075 | 123 | 0.35% | 75,012 | 167 | 0.30% | 37,696 | 35 | 0.36% | 81, |
| Total earning assets | 1,146,252 | 39,320 | 4.58% | 1,058,299 | 37,006 | 4.68% | 1,160,479 | 13,015 | 4.46% | 1,142, |
| Non-earning assets: | | | | | | | | | | |
| Cash and due from banks | 23,967 | | | 22,380 | | | 24,823 | | | 23, |
| Premises and equipment, net | 24,762 | | | 24,270 | | | 24,585 | | | 24, |
| Other assets | 51,815 | | | 45,863 | | | 49,482 | | | 51, |
| Allowance for loan losses | (10,262) | | | (9,731) | | | (10,534) | | | (9, |
| AFS valuation allowance | 13,698 | | | 11,690 | | | 13,813 | | | 13, |
| Total | \$ 1,250,232 | | | \$ 1,152,771 | | | \$ 1,262,648 | | | \$ 1,246, |
| Liabilities and Shareholders' Equity | | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | | |
| Interest-bearing demand deposits | \$ 88,005 | \$ 70 | 0.11% | \$ 71,906 | \$ 63 | 0.12% | \$ 92,703 | \$ 25 | 0.11% | \$ 80, |
| Savings and insured money market deposits | 409,081 | 668 | 0.22% | 345,040 | 663 | 0.26% | 415,368 | 222 | 0.21% | 371, |
| Time deposits | 261,549 | 1,795 | 0.92% | 295,080 | 2,600 | 1.18% | 252,826 | 528 | 0.83% | 314, |
| Federal Home Loan Bank advances and securities sold under agreements to Repurchase | 73,944 | 1,631 | 2.95% | 79,984 | 1,839 | 3.07% | 65,039 | 465 | 2.85% | 86, |
| Total interest-bearing liabilities | 832,579 | 4,164 | 0.67% | 792,010 | 5,165 | 0.87% | 825,936 | 1,240 | 0.60% | 852, |

Non-interest-bearing liabilities:

| | | | | |
|-----------------------------|--------------|--------------|--------------|--------------|
| Demand deposits | 278,473 | 235,656 | 294,612 | 255,914 |
| Other liabilities | 8,962 | 8,096 | 9,914 | 9,914 |
| Total liabilities | 1,120,014 | 1,035,762 | 1,130,462 | 1,118,742 |
| Shareholders' equity | 130,218 | 117,009 | 132,186 | 128,742 |
| Total | \$ 1,250,232 | \$ 1,152,771 | \$ 1,262,648 | \$ 1,246,484 |
| Net interest income | \$ 35,156 | \$ 31,841 | \$ 11,775 | \$ 11,775 |
| Net interest rate spread(1) | 3.91% | 3.81% | 3.86% | 3.86% |
| Net interest margin(2) | 4.10% | 4.02% | 4.04% | 4.04% |

(1) Net interest rate spread is the difference in the yield received on earning assets less the rate paid on interest-bearing liabilities.

(2) Net interest margin is the ratio of net interest income divided by average earning assets.

The following table demonstrates the impact on net interest income of the changes in the volume of earning assets and interest-bearing liabilities and changes in rates earned and paid by the Corporation. For purposes of constructing this table, average investment securities are at average amortized cost and earning asset averages include non-performing loans. Therefore, the impact of changing levels of non-performing loans is reflected in the change due to rate, but does not affect changes due to volume. No tax equivalent adjustments were made.

| | Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011 | | | Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011 | | |
|--|--|-----------|-----------|---|-----------|---------|
| | Increase (Decrease) Due to (1) | | | Increase (Decrease) Due to (1) | | |
| | Volume | Rate | Net | Volume | Rate | Net |
| Interest and dividends earned on: | | | | | | |
| Loans | \$4,483 | \$(1,861) | \$ 2,622 | \$1,144 | \$(1,443) | \$(299) |
| Taxable securities | 225 | (431) | (206) | (102) | (96) | (198) |
| Tax-exempt securities | (39) | (19) | (58) | (41) | (10) | (51) |
| Interest-bearing deposits | (69) | 25 | (44) | (39) | 9 | (30) |
| Total earning assets | \$3,056 | \$ (742) | \$ 2,314 | \$ 199 | (777) | (578) |
| Interest paid on: | | | | | | |
| Demand deposits | \$ 13 | \$ (6) | \$ 7 | \$ 4 | \$ (4) | \$ - |
| Savings and insured money market deposits | 114 | (109) | 5 | 27 | (53) | (26) |
| Time deposits | (273) | (532) | (805) | (152) | (185) | (337) |
| Federal Home Loan Bank advances and securities sold under agreements to repurchase | (135) | (73) | (208) | (156) | 9 | (147) |
| Total interest-bearing liabilities | \$ 255 | \$(1,256) | \$(1,001) | \$ (54) | \$ (456) | \$(510) |
| | \$2,801 | \$ 514 | \$ 3,315 | \$ 253 | \$ (321) | \$ (68) |

Net interest
income

(1) The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Liquidity and Capital Resources

Liquidity management involves the ability to meet the cash flow requirements of deposit customers, borrowers, and the operating, investing, and financing activities of the Corporation. The Corporation uses a variety of resources to meet its liquidity needs. These include short term investments, cash flow from lending and investing activities, core deposit growth and non-core funding sources, such as time deposits of \$100,000 or more, securities sold under agreements to repurchase and other borrowings.

The Corporation is a member of the FHLB, which allows it to access borrowings which enhance management's ability to satisfy future liquidity needs. Based on available collateral and current advances outstanding, the Corporation was eligible to borrow up to a total of \$96.2 million and \$69.8 million at September 30, 2012 and December 31, 2011, respectively.

During the nine months ended September 30, 2012, cash and cash equivalents increased \$28.3 million compared with an increase of \$57.9 million during the same period for the prior year. In addition to cash provided by operating activities, major sources of cash during the nine months ended September 30, 2012, included proceeds from sales, maturities, calls and principal reductions on securities totaling \$95.5 million and a \$84.7 million increase in deposits. Proceeds from the above were used primarily to fund purchases of securities totaling \$65.9 million, a \$78.4 million increase in loans, a \$15.3 million reduction in FHLB long term advances, a decrease in securities sold under agreements to repurchase totaling \$4.2 million, the payment of cash dividends in the amount of \$3.4 million and purchases of fixed assets totaling \$2.3 million.

In addition to cash provided by operating activities, major sources of cash during the nine months ended September 30, 2011, included proceeds from sales, maturities, calls and principal reductions on securities totaling \$94.8 million, a \$55.4 million increase in deposits and \$25.1 million in net cash received in the FOFC acquisition. These proceeds were used primarily to fund purchases of securities totaling \$99.2 million, a net decrease in securities sold under agreements to repurchase totaling \$13.9 million, a \$11.0 million net increase in loans, the payment of cash dividends in the amount of \$2.9 million and purchases of fixed assets totaling \$1.3 million, as well as \$0.8 million increase in FHLB and Federal Reserve Bank stock and purchases of treasury shares totaling \$0.3 million.

As of September 30, 2012, the Bank's leverage ratio was 8.30%. The Tier I and Total Risk Adjusted Capital ratios were 11.18% and 12.65%, respectively. All of the above ratios are in excess of the requirements for being considered "well capitalized" by the FDIC, the Federal Reserve and the New York State Department of Financial Services.

During the nine months ended September 30, 2012, the Corporation declared cash dividends totaling \$0.75 per share, unchanged from the dividends declared during the same period of 2011.

When shares of the Corporation become available in the market, the Corporation may purchase them after careful consideration of its capital position. On November 16, 2011, the Corporation's Board of Directors approved a one year extension of the stock repurchase program that had been initially approved on November 18, 2009 and extended for one year on November 17, 2010. The extension authorizes the purchase of up to 90,000 shares of the Corporation's outstanding common stock, including those shares purchased during the first two years of the plan. Purchases may be made from time to time on the open market or in privately negotiated transactions at the discretion of management. Through September 30, 2012, a total of 66,364 shares had been purchased under this program. During the nine months ended September 30, 2012, the Corporation purchased 23,120 shares at an average cost of \$25.05 per share. During the nine months ended September 30, 2012, the Corporation re-issued 29,126 shares from treasury to fund the stock component of directors' 2011 compensation, distributions under the directors' deferred compensation plan, stock grants to executive officers and funding for the Corporation's Profit Sharing, Savings and Investment Plan.

Interest Rate Risk

As intermediaries between borrowers and savers, commercial banks incur both interest rate risk and liquidity risk. The Corporation's Asset/Liability Committee (ALCO) has the strategic responsibility for setting the policy guidelines on acceptable exposure to these areas. These guidelines contain specific measures and limits regarding these risks, which are monitored on a regular basis. The ALCO is made up of the president & chief executive officer, the chief financial officer, the asset liability management officer, and other officers representing key functions.

The ALCO is also responsible for supervising the preparation and annual revisions of the financial segments of the annual budget, which is built upon the committee's economic and interest-rate assumptions. It is the responsibility of the ALCO to modify prudently the Corporation's asset/liability policies.

Interest rate risk is the risk that net interest income will fluctuate as a result of a change in interest rates. It is the assumption of interest rate risk, along with credit risk, that drives the net interest margin of a financial institution. For that reason, the ALCO has established tolerance limits based upon a 200-basis point change in interest rates. At September 30, 2012, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the next 12 months net interest income by 10.05% and an immediate 200-basis point increase would negatively impact the next 12 months net interest income by 3.97%. Both are within the Corporation's policy guideline of 15% established by ALCO. Given the overall low level of current interest rates and the unlikely event of a 200-basis point decline from this point, management additionally modeled an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates. When applied, it is estimated these scenarios would result in negative impacts to net interest income of 5.29% and 6.32%, respectively. Management is comfortable with the amount of exposure at these levels.

A related component of interest rate risk is the expectation that the market value of our capital account will fluctuate with changes in interest rates. This component is a direct corollary to the earnings-impact component: an institution exposed to earnings erosion is also exposed to shrinkage in market value. At September 30, 2012, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the market value of our capital account by 5.40% and an immediate 200-basis point increase in interest rates would positively impact the market value by 1.37%. Both are within the established tolerance limit of 15%. Management also modeled the impact to the market value of our capital with an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates, based on the current interest rate environment. When applied, it is estimated these scenarios would result in negative impacts to the market value of our capital of 7.10% and 0.32%, respectively. Management is also comfortable with the level of exposures at these levels.

Management does recognize the need for certain hedging strategies during periods of anticipated higher fluctuations in interest rates and the Board-approved Funds Management Policy provides for limited use of certain derivatives in asset liability management. These strategies were not employed during the nine months ended September 30, 2012.

Adoption of New Accounting Standards

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

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

Item 3: Quantitative and Qualitative Disclosures About Market Risk

Information required by this Item is set forth herein in Management's Discussion and Analysis of Financial Condition and Results of Operations under the heading "Interest Rate Risk."

Item 4: Controls and Procedures

The Corporation's management, with the participation of our President and Chief Executive Officer, who is the Corporation's principal executive officer, and our Treasurer and Chief Financial Officer, who is the Corporation's principal financial officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures as of September 30, 2012 pursuant to Rule 13a-15 of the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the principal executive officer and principal financial officer have concluded that the Corporation's disclosure controls and procedures are effective as of September 30, 2012. In addition, there have been no changes in the Corporation's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART OTHER INFORMATION

II.

Item 1. Legal Proceedings

For information related to this item please see Note 7 to the Corporation's financial statements included herein.

Item 2. Risk Factors

1A.

There have been no material changes in the risk factors set forth in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission on March 28, 2012.

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

(c) Issuer Purchases of Equity Securities (1)

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|-----------------------|----------------------------------|------------------------------|--|--|
| 7/1/12-7/31/12 | 73 | \$ 25.70 | 73 | 27,585 |
| 8/1/12-8/31/12 | 123,949 | \$ 24.59 | 3,949 | 23,636 |
| 9/1/12-9/30/12 | - | \$ - | - | 23,636 |
| Quarter ended 9/30/12 | 4,022 | \$ 24.61 | 4,022 | 23,636 |

(1) On November 16, 2011, the Corporation's Board of Directors approved a one year extension of the stock repurchase program that had been initially approved on November 18, 2009 and extended for one year on November 17, 2010. The extension authorizes purchases of up to 90,000 shares of the Corporation's outstanding common stock, including those shares purchased during the first two years of the plan. Purchases may be made from time to time on the open-market or in private negotiated transactions and will be at the discretion of management. Through September 30, 2012, a total of 66,364 shares had been purchased under this program.

Item EXHIBITS

6.

The following exhibits are either filed with this Form 10-Q or are incorporated herein by reference:

3.1 Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984. Filed as Exhibit 3.1 to Registrant's Form 10-K filed with the SEC on March 13, 2008 and incorporated herein by reference.

3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988. Filed as Exhibit 3.2 to Registrant's Form 10-K filed with the SEC on March 13, 2008 and incorporated herein by reference.

3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998. Filed as Exhibit 3.4 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated herein by reference.

3.4 Amended and Restated Bylaws of the Registrant, as amended to May 16, 2012. Filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 18, 2012 and incorporated herein by reference.

31.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

31.2 Certification of Treasurer and Chief Financial Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

32.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.

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101.INS Instance Document

101.SCH XBRL Taxonomy Schema

101.CAL XBRL Taxonomy Calculation Linkbase

101.DEF XBRL Taxonomy Definition Linkbase

101.LAB XBRL Taxonomy Label Linkbase

101.PRE XBRL Taxonomy Presentation Linkbase

SIGNATURES

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

CHEMUNG FINANCIAL CORPORATION

DATED: November
13, 2012

By: /s/ Ronald M. Bentley
Ronald M. Bentley, President and Chief Executive Officer
(Principal Executive Officer)

DATED: November
13, 2012

By: /s/ Mark A. Severson
Mark A. Severson, Treasurer and Chief Financial Officer
(Principal Financial and Accounting Officer)

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