PENNS WOODS BANCORP INC
Form 10-K
March 10, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC. 20549

FORM 10-K

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

For the transition period from to

Commission file number 0-17077

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

Pennsylvania	23-2226454
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

300 Market Street, P.O. Box 967 Williamsport, Pennsylvania	17703-0967

Registrant’s telephone number, including area code (570) 322-1111

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange which registered
Common Stock, par value $8.33 per share	The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. o Yes ý No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. o Yes ý No

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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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 definition of “large accelerated filer”, “accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes ý No

State the aggregate market value of the voting stock held by non-affiliates of the registrant $198,763,192 at June 30, 2016.

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Class	Outstanding at March 1, 2017
Common Stock, $8.33 Par Value	4,734,952 Shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement prepared in connection with its annual meeting of shareholders to be held on April 25, 2017 are incorporated by reference in Part III hereof.

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PART I

ITEM 1 BUSINESS

A. General Development of Business and History

On January 7, 1983, Penns Woods Bancorp, Inc. (the “Company”) was incorporated under the laws of the Commonwealth of Pennsylvania as a bank holding company. In connection with the organization of the Company, Jersey Shore State Bank ("JSSB"), a Pennsylvania state-chartered bank, became a wholly owned subsidiary of the Company. On June 1, 2013 the Company acquired Luzerne Bank ("Luzerne") with Luzerne operating as a subsidiary of the Company (JSSB and Luzerne are collectively referred to as the "Banks"). The Company’s two other wholly-owned subsidiaries are Woods Real Estate Development Company, Inc. and Woods Investment Company, Inc. The Company’s business has consisted primarily of managing and supervising the Banks, and its principal source of income has been dividends paid by the Banks and Woods Investment Company, Inc.

The Banks are engaged in commercial and retail banking which includes the acceptance of time, savings, and demand deposits, the funding of commercial, consumer, and mortgage loans, and safe deposit services. Utilizing a branch office network, ATMs, Internet, and telephone banking delivery channels, the Banks deliver their products and services to the communities they reside in.

In October 2000, JSSB acquired The M Group, Inc. D/B/A The Comprehensive Financial Group (“The M Group”). The M Group, which operates as a subsidiary of JSSB, offers insurance and securities brokerage services. Securities are offered by The M Group through Voya Financial a registered broker-dealer.

Neither the Company nor the Banks anticipate that compliance with environmental laws and regulations will have any material effect on capital expenditures, earnings, or their competitive position. The Banks are not dependent on a single customer or a few customers, the loss of whom would have a material effect on the business of the Banks.

JSSB employed 229 persons, Luzerne employed 63 persons, and The M Group employed 4 persons as of December 31, 2016 in either a full-time or part-time capacity. The Company does not have any employees. The principal officers of the Banks also serve as officers of the Company.

Woods Investment Company, Inc., a Delaware holding company, maintains an investment portfolio that is managed for total return and to fund dividend payments to the Company.

Woods Real Estate Development Company, Inc. serves the Company through its acquisition and ownership of certain properties utilized by the Bank.

We post publicly available reports required to be filed with the SEC on our website, www.jssb.com, as soon as reasonably practicable after filing such reports with the SEC. The required reports are available free of charge through our website. Information available on our website is not part of or incorporated by reference into this Report or any other report filed by this Company with the SEC.

B. Regulation and Supervision

The Company is a registered bank holding company and, as such is subject to the provisions of the Bank Holding Company Act of 1956, as amended (the “BHCA”) and to supervision and examination by the Board of Governors of the Federal Reserve System (the “FRB”). The Banks are also subject to the supervision and examination by the Federal Deposit Insurance Corporation (the “FDIC”), as their primary federal regulator and as the insurer of the Banks' deposits.

The Banks are also regulated and examined by the Pennsylvania Department of Banking and Securities (the "Department").

The insurance activities of The M Group are subject to regulation by the insurance departments of the various states in which The M Group, conducts business including principally the Pennsylvania Department of Insurance. The securities brokerage activities of The M Group are subject to regulation by federal and state securities commissions.

The FRB has issued regulations under the BHCA that require a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. As a result, the FRB, pursuant to such regulations, may require the Company to stand ready to use its resources to provide adequate capital funds to the Banks during periods of financial stress or adversity. The BHCA requires the Company to secure the prior approval of the FRB before it can acquire all or substantially all of the assets of any bank, or acquire ownership or control of 5% or more of any voting shares of any bank. Such a transaction would also require approval of the Department.

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A bank holding company is prohibited under the BHCA from engaging in, or acquiring direct or indirect control of, more than 5% of the voting shares of any company engaged in non-banking activities unless the FRB, by order or regulation, has found such activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Under the BHCA, the FRB has the authority to require a bank holding company to terminate any activity or relinquish control of a non-bank subsidiary (other than a non-bank subsidiary of a bank) upon the FRB's determination that such activity or control constitutes a serious risk to the financial soundness and stability of any bank subsidiary of the bank holding company.

In July 2013, the federal bank regulatory agencies adopted revisions to the agencies' capital adequacy guidelines and prompt corrective action rules, which were designed to enhance such requirements and implement the revised standards of the Basel Committee on Banking Supervision, commonly referred to as Basel III. The final rules generally implement higher minimum capital requirements, add a new common equity tier 1 capital requirement, and establish criteria that instruments must meet to be considered common equity tier 1 capital, additional tier 1 capital or tier 2 capital. The new minimum capital to risk-adjusted assets requirements are a common equity tier 1 capital ratio of 4.5% (6.5% to be considered "well capitalized") and a tier 1 capital ratio of 6.0%, increased from 4.0% (and increased from 6.0% to 8.0% to be considered "well capitalized"); the total capital ratio remains at 8.0% under the new rules (10.0% to be considered "well capitalized"). Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity tier 1 capital above its minimum risk-based capital requirements in an amount greater than 2.5% of total risk-weighted assets. The new minimum capital requirements became effective on January 1, 2015. The capital contribution buffer requirements phase in over a three-year period that began on January 1, 2016.

In addition to the risk-based capital guidelines, the FRB requires each bank holding company to comply with the leverage ratio, under which the bank holding company must maintain a minimum level of Tier 1 capital to average total consolidated assets of 4.0% (5.0% to be considered "well capitalized"). The Banks are subject to similar capital requirements adopted by the FDIC.

Dividends

Federal and state laws impose limitations on the payment of dividends by the Banks. The Pennsylvania Banking Code restricts the availability of capital funds for payment of dividends by the Banks to their additional paid-in capital.

In addition to the dividend restrictions described above, the banking regulators have the authority to prohibit or to limit the payment of dividends by the Banks if, in the banking regulator's opinion, payment of a dividend would constitute an unsafe or unsound practice in light of the financial condition of the Banks.

Under Pennsylvania law, the Company may not pay a dividend, if, after giving effect thereto, it would be unable to pay its debts as they become due in the usual course of business and, after giving effect to the dividend, the total assets of the Company would be less than the sum of its total liabilities plus the amount that would be needed, if the Company were to be dissolved at the time of distribution, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to those receiving the dividend.

It is also the policy of the FRB that a bank holding company generally only pay dividends on common stock out of net income available to common shareholders over the past twelve months and only if the prospective rate of earnings retention appears consistent with a bank holding company's capital needs, asset quality, and overall financial condition. In the current financial and economic environment, the FRB has indicated that bank holding companies should carefully review their dividend policy and has discouraged dividend pay-out ratios at the 100% level unless

both asset quality and capital are very strong. A bank holding company also should not maintain a dividend level that places undue pressure on the capital of such institution's subsidiaries, or that may undermine the bank holding company's ability to serve as a source of strength for such subsidiaries.

C. Regulation of the Banks

The Banks are highly regulated by the FDIC and the Department. The laws that such agencies enforce limit the specific types of businesses in which the Banks may engage, and the products and services that the Banks may offer to customers. Generally, these limitations are designed to protect the insurance fund of the FDIC and/or the customers of the Banks, and not the Banks or its shareholders. From time to time, various types of new federal and state legislation have been proposed that could result in additional regulation of, and restrictions on, the business of the Banks. It cannot be predicted whether any such legislation will be adopted or how such legislation would affect business of the Banks. As a consequence of the extensive regulation of commercial banking activities in the United States, the Banks' business is particularly susceptible to being affected by federal legislation and regulations

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that may increase the costs of doing business. Some of the major regulatory provisions that affect the business of the Banks are discussed briefly below.

Prompt Corrective Action

The FDIC has specified the levels at which an insured institution will be considered “well-capitalized,” “adequately capitalized,” “undercapitalized,” and “critically undercapitalized.” In the event an institution’s capital deteriorates to the “undercapitalized” category or below, the Federal Deposit Insurance Act (the “FDIA”) and FDIC regulations prescribe an increasing amount of regulatory intervention, including: (1) the institution of a capital restoration plan by a bank and a guarantee of the plan by a parent institution and liability for civil money damages for failure to fulfill its commitment on that guarantee; and (2) the placement of a hold on increases in assets, number of branches, or lines of business. If capital has reached the significantly or critically undercapitalized levels, further material restrictions can be imposed, including restrictions on interest payable on accounts, dismissal of management and (in critically undercapitalized situations) appointment of a receiver. For well-capitalized institutions, the FDIA provides authority for regulatory intervention where the institution is deemed to be engaging in unsafe or unsound practices or receives a less than satisfactory examination report rating for asset quality, management, earnings or liquidity.

Deposit Insurance

The FDIC maintains the Deposit Insurance Fund ("DIF") by assessing depository institutions an insurance premium. The FDIC has set the amount of deposits it insures to $250,000.

As mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the assessment base that the FDIC uses to calculate assessment premiums is a bank’s average assets minus average tangible equity. The range of assessment rates is a low of 2.5 basis points to a high of 45 basis points, per $100 of assets.

The FDIC is required under the Dodd-Frank Act to establish assessment rates that will allow the DIF to achieve a reserve ratio of 1.35% of insured deposits by September 2020. In addition, the FDIC has established a “designated reserve ratio” of 2.0%, a target ratio that, until it is achieved, will not likely result in the FDIC reducing assessment rates. In attempting to achieve the mandated 1.35% ratio, the FDIC is required to implement assessment formulas that charge banks over $10 billion in asset size more than banks under that size. Under the Dodd-Frank Act, the FDIC is authorized to make reimbursements from the insurance fund to banks if the reserve ratio exceeds 1.50%, but the FDIC has adopted the “designated reserve ratio” of 2.0% and has announced that any reimbursements from the fund are indefinitely suspended.

Federal Home Loan Bank System

The Banks are a member of the Federal Home Loan Bank of Pittsburgh (the “FHLB”), which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the Federal Home Loan Bank. At December 31, 2016, the Banks had $85,625,000 in FHLB advances.

As a member, the Banks are required to purchase and maintain stock in the FHLB. The amount of required stock varies based on the FHLB products utilitied by the Banks and the amount of the products utilized. At December 31, 2016, the Banks had $8,344,300 in stock of the FHLB which was in compliance with this requirement.

Other Legislation

The Dodd-Frank Act was enacted on July 21, 2010 and significantly changed the bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The federal agencies are given significant discretion in drafting rules and regulations to implement the Dodd-Frank Act, and consequently, much of the impact of the Dodd-Frank Act may not be known for some time.

Certain provisions of the Dodd-Frank Act have already impacted the Company. For example, effective July 21, 2011, a provision of the Dodd-Frank Act eliminated the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on the Company's interest expense. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2008.

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Bank and thrift holding companies with assets of less than $15 billion as of December 31, 2009, such as the Company, will be permitted to include trust preferred securities that were issued before May 19, 2010, as Tier 1 capital; however, trust preferred securities issued by a bank or thrift holding company (other than those with assets of less than $500 million) after May 19, 2010, will no longer count as Tier 1 capital. Trust preferred securities still will be entitled to be treated as Tier 2 capital.

The Dodd-Frank Act requires publicly traded companies to give shareholders a non-binding vote on executive compensation and so-called “golden parachute” arrangements, and may allow greater access by shareholders to the company’s proxy material by authorizing the SEC to promulgate rules that would allow shareholders to nominate their own candidates using a company’s proxy materials. The legislation also directs the FRB to promulgate rules prohibiting excessive compensation paid to bank holding company executives, regardless of whether the company is publicly traded.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets such as the Banks will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakens the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

It is difficult to predict at this time the specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on financial institutions’ operations is presently unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

The Sarbanes-Oxley Act of 2002 was enacted to enhance penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures under the federal securities laws. The Sarbanes-Oxley Act generally applies to all companies, including the Company, that file or are required to file periodic reports with the Securities and Exchange Commission under the Securities Exchange Act of 1934, or the Exchange Act. The legislation includes provisions, among other things, governing the services that can be provided by a public company’s independent auditors and the procedures for approving such services, requiring the chief executive officer and principal accounting officer to certify certain matters relating to the company’s periodic filings under the Exchange Act, requiring expedited filings of reports by insiders of their securities transactions and containing other provisions relating to insider conflicts of interest, increasing disclosure requirements relating to critical financial accounting policies and their application, increasing penalties for securities law violations, and creating a new public accounting oversight board, a regulatory body subject to SEC jurisdiction with broad powers to set auditing, quality control, and ethics standards for accounting firms. In response to the legislation, the national securities exchanges and NASDAQ have adopted new rules relating to certain matters, including the independence of members of a company’s audit committee as a condition to listing or continued listing.

Congress is often considering some financial industry legislation, and the federal banking agencies routinely propose new regulations. The Company cannot predict how any new legislation, or new rules adopted by federal or state

banking agencies, may affect the business of the Company and its subsidiaries in the future. Given that the financial industry remains under stress and severe scrutiny, and given that the U.S. economy has not yet fully recovered to pre-crisis levels of activity, the Company expects that there will be significant legislation and regulatory actions that may materially affect the banking industry for the foreseeable future.

Environmental Laws

Environmentally related hazards have become a source of high risk and potential liability for financial institutions relating to their loans. Environmentally contaminated properties owned by an institution's borrowers may result in a drastic reduction in the value of the collateral securing the institution's loans to such borrowers, high environmental clean up costs to the borrower affecting its ability to repay the loans, the subordination of any lien in favor of the institution to a state or federal lien securing clean up costs, and liability to the institution for clean up costs if it forecloses on the contaminated property or becomes involved in the management of the borrower. The Company is not aware of any borrower who is currently subject to any environmental investigation or clean up proceeding which is likely to have a material adverse effect on the financial condition or results of operations of the Company.

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Effect of Government Monetary Policies

The earnings of the Company are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States Government and its agencies. The monetary policies of the FRB have had, and will likely continue to have, an important impact on the operating results of commercial banks through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The FRB has a major effect upon the levels of bank loans, investments, and deposits through its open market operations in the United States Government securities and through its regulation of, among other things, the discount rate on borrowings by member banks and the reserve requirements against member bank deposits. It is not possible to predict the nature and impact of future changes in monetary and fiscal policies.

DESCRIPTION OF THE BANKS

History and Business

JSSB was incorporated under the laws of the Commonwealth of Pennsylvania as a state bank in 1934 and became a wholly owned subsidiary of the Company on July 12, 1983.

As of December 31, 2016, JSSB had total assets of $986,486,000; total shareholders’ equity of $84,020,000; and total deposits of $770,937,000. JSSB's deposits are insured by the FDIC for the maximum amount provided under current law.

Luzerne was acquired by the Company on June 1, 2013. As of December 31, 2016, Luzerne had total assets of $387,695,000; total shareholders’ equity of $45,401,000; and total deposits of $328,812,000. Luzerne's deposits are insured by the FDIC for the maximum amount provided under current law.

The Banks engage in business as commercial banks, doing business at locations in Lycoming, Clinton, Centre, Montour, Union and Luzerne Counties, Pennsylvania. The Banks offer insurance, securities brokerage services, annuity and mutual fund investment products, and financial planning through the M Group.

Services offered by the Banks include accepting time, demand and savings deposits including Super NOW accounts, statement savings accounts, money market accounts, and fixed rate certificates of deposit. Their services also include making secured and unsecured business and consumer loans that include financing commercial transactions as well as construction and residential mortgage loans and revolving credit loans with overdraft protection.

The Banks' loan portfolio mix can be classified into three principal categories. These are commercial and agricultural, real estate, and consumer. Real estate loans can be further segmented into residential, commercial, and construction. Qualified borrowers are defined by our loan policy and our underwriting standards. Owner provided equity requirements range from 0% to 35%, depending on the collateral offered for the loan. Terms are generally restricted to 30 years or less with the exception of construction and land development, which are generally limited to one and five years, respectively. Real estate appraisals, property construction verifications, and site visitations comply with our loan policy and with industry regulatory standards.

Prospective residential mortgage customer’s repayment ability is determined from information contained in the application and recent income tax returns, or other verified income sources. Emphasis is on credit, employment, income, and residency verification. Broad hazard insurance is always required and flood insurance where applicable. In the case of construction mortgages, builders risk insurance is requested.

Agricultural loans for the purchase or improvement of real estate must meet the Banks' real estate underwriting criteria. Agricultural loans made for the purchase of equipment are usually payable in five years, but never more than ten, depending upon the useful life of the purchased asset. Minimum borrower equity ranges from 0% to 35% depending on the purpose. Livestock financing criteria depends upon the nature of the operation. Agricultural loans are also made for crop production purposes. Such loans are structured to repay within the production cycle and not carried over into a subsequent year.

Commercial loans are made for the acquisition and improvement of real estate, purchase of equipment, and for working capital purposes on a seasonal or revolving basis. General purpose working capital loans are also available with repayment expected within one year. Equipment loans are generally amortized over three to ten years. Insurance coverage with the Banks as loss payee is required, especially in the case where the equipment is rolling stock. It is also a general policy to collateralize non-real estate loans with the asset purchased and, dependant upon loan terms, junior liens are filed on other available assets. Financial information required on all commercial mortgages includes the most current three years balance sheets and income statements and projections on income to be developed through the project. In the case of corporations and partnerships, the principals are often asked to personally guaranty the entity’s debt.

Seasonal and revolving lines of credit are offered for working capital purposes. Collateral for such a loan may vary but often includes the pledge of inventory and/or receivables. Drawing availability is usually 50% of inventory and 80% of eligible receivables. Eligible receivables are defined as invoices less than 90 days delinquent. Exclusive reliance is very seldom placed on such collateral; therefore, other lienable assets are also taken into the collateral pool. Where reliance is placed on inventory and accounts receivable, the applicant must provide financial information including agings on a specified basis. In addition, the guaranty of the principals is usually obtained.

Letter of credit availability is usually limited to standby or performance letters of credit where the customer is well known to the Banks. The credit criteria is the same as that utilized in making a direct loan. Collateral is obtained in most cases.

Consumer loan products include residential mortgages, home equity loans and lines, automobile financing, personal loans and lines of credit, overdraft and check lines. Our policy includes standards used in the industry on debt service ratios and terms are consistent with prudent underwriting standards and the use of proceeds. Verifications are made of employment and residency, along with credit history.

Second mortgages are confined to equity borrowing and home improvements. Terms are generally fifteen years or less. Loan to collateral value criteria is 90% or less and verifications are made to determine values. Automobile financing is generally restricted to five years and done on both an indirect and direct basis. The Banks, as a practice, do not floor plan and therefore do not discount dealer paper. Small loan requests are to accommodate personal needs such as debt consolidation or the purchase of small appliances. Overdraft check lines are usually limited to $5,000 or less.

The Banks' investment portfolios are analyzed and priced on a monthly basis. Investments are made in U.S. Treasuries, U.S. Agency issues, bank qualified tax-exempt municipal bonds, taxable municipal bonds, corporate bonds, and corporate stocks which consist of Pennsylvania bank stocks. Bonds with BBB or better ratings are used, unless a local issue is purchased that has a lesser or no rating. Factors taken into consideration when investments are purchased include liquidity, the Company’s tax position, tax equivalent yield, third party investment ratings, and the policies of the Asset/Liability Committee.

The banking environment in Lycoming, Clinton, Centre, Montour, Union and Luzerne Counties, Pennsylvania is highly competitive. The Banks operate twenty-three full service offices in these markets and compete for loans and deposits with numerous commercial banks, savings and loan associations, and other financial institutions. The economic base of the region is developed around small business, health care, educational facilities (college and public schools), light manufacturing industries, and agriculture.

The Banks have a relatively stable deposit base and no material amount of deposits is obtained from a single depositor or group of depositors, excluding public entities that account for approximately 15% of total deposits. Although the Banks have regular opportunities to bid on pools of funds of $100,000 or more in the hands of municipalities, hospitals, and others, it does not rely on these monies to fund loans or intermediate or longer-term investments.

The Banks have not experienced any significant seasonal fluctuations in the amount of deposits. The Banks have experienced an outflow of deposits related to municipalities and school districts due to the ongoing Commonwealth of Pennsylvania budget impass.

Supervision and Regulation

As referenced elsewhere, the banking business is highly regulated, and the Banks are only able to engage in business activities, and to provide products and services, that are permitted by applicable law and regulation. In addition, the earnings of the Banks are affected by the policies of regulatory authorities including the FDIC and the FRB. An important function of the FRB is to regulate the money supply and interest rates. Among the instruments used to implement these objectives are open market operations in U.S. Government Securities, changes in reserve requirements against member bank deposits, and limitations on interest rates that member banks may pay on time and savings deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, and their use may also affect interest rates charged on loans or paid for deposits.

The policies and regulations of the FRB have had and will probably continue to have a significant effect on the Banks' deposits, loans and investment growth, as well as the rate of interest earned and paid, and are expected to affect the Banks' operation in the future. The effect of such policies and regulations upon the future business and earnings of the Banks cannot accurately be predicted.

ITEM 1A RISK FACTORS

The following sets forth several risk factors that may affect the Company's financial condition or results of operations.

Changes in interest rates could reduce our income, cash flows and asset values.

Our income and cash flows and the value of our assets depend to a great extent on the difference between the interest rates we earn on interest-earning assets, such as loans and investment securities, and the interest rates we pay on interest-bearing liabilities such as deposits and borrowings. These rates are highly sensitive to many factors which are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, will influence not only the interest we receive on our loans and investment securities and the amount of interest we pay on deposits and borrowings but will also affect our ability to originate loans and obtain deposits and the value of our investment portfolio. If the rate of interest we pay on our deposits and other borrowings increases more than the rate of interest we earn on our loans and other investments, our net interest income, and therefore our earnings, could be adversely affected. Our earnings also could be adversely affected if the rates on our loans and other investments fall more quickly than those on our deposits and other borrowings.

Economic conditions either nationally or locally in areas in which our operations are concentrated may adversely affect our business.

Deterioration in local, regional, national, or global economic conditions could cause us to experience a reduction in deposits and new loans, an increase in the number of borrowers who default on their loans, and a reduction in the value of the collateral securing their loans, all of which could adversely affect our performance and financial condition. Unlike larger banks that are more geographically diversified, we provide banking and financial services locally. Therefore, we are particularly vulnerable to adverse local economic conditions.

Our financial condition and results of operations would be adversely affected if our allowance for loan losses is not sufficient to absorb actual losses or if we are required to increase our allowance.

Despite our underwriting criteria, we may experience loan delinquencies and losses. In order to absorb losses associated with nonperforming loans, we maintain an allowance for loan losses based on, among other things, historical experience, an evaluation of economic conditions, and regular reviews of delinquencies and loan portfolio quality. Determination of the allowance inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. At any time there are likely to be loans in our portfolio that will result in losses but that have not been identified as nonperforming or potential problem credits. We cannot be sure that we will be able to identify deteriorating credits before they become nonperforming assets or that we will be able to limit losses on those loans that are identified. We may be required to increase our allowance for loan losses for any of several reasons. Federal regulators, in reviewing our loan portfolio as part of a regulatory examination, may request that we increase our allowance for loan losses. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in our allowance. In addition, if charge-offs in future periods exceed our allowance for loan losses, we will need additional increases in our allowance for loan losses. Any increases in our allowance for loan losses will result in a decrease in our net income and, possibly, our capital, and may materially affect our results of operations in the period in which the allowance is increased.

Many of our loans are secured, in whole or in part, with real estate collateral which is subject to declines in value.

In addition to considering the financial strength and cash flow characteristics of a borrower, we often secure our loans with real estate collateral. Real estate values and the real estate market are generally affected by, among other things, changes in local, regional or national economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies, and acts of nature.

The real estate collateral provides an alternate source of repayment in the event of default by the borrower. If real estate prices in our markets decline, the value of the real estate collateral securing our loans could be reduced. If we are required to liquidate real estate collateral securing loans during a period of reduced real estate values to satisfy the debt, our earnings and capital could be adversely affected.

Our information systems may experience an interruption or breach in security.
We rely heavily on communications and information systems to conduct our business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer-relationship management, general ledger, deposit, loan and other systems. While we have policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of our information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur; or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, result in a loss of customer business, subject us to additional

regulatory scrutiny or expose us to civil litigation and possible financial liability; any of which could have a material adverse effect on our financial condition and results of operations.

We face the risk of cyber-attack to our computer systems.

Our computer systems, software and networks have been and will continue to be vulnerable to unauthorized access, loss or destruction of data (including confidential client information), account takeovers, unavailability of service, computer viruses or other malicious code, cyber-attacks and other events. These threats may derive from human error, fraud or malice on the part of employees or third parties, or may result from accidental technological failure. If one or more of these events occurs, it could result in the disclosure of confidential client information, damage to our reputation with our clients and the market, additional costs to us (such as repairing systems or adding new personnel or protection technologies), regulatory penalties and financial losses, to both us and our clients and customers. Such events could also cause interruptions or malfunctions in our operations (such as the lack of availability of our online banking system), as well as the operations of our clients, customers or other third parties. Although we maintain safeguards to protect against these risks, there can be no assurance that we will not suffer losses in the future that may be material in amount.

Competition may decrease our growth or profits.

We face substantial competition in all phases of our operations from a variety of different competitors, including commercial banks, savings and loan associations, mutual savings banks, credit unions, consumer finance companies, factoring companies, leasing companies, insurance companies, and money market mutual funds. There is very strong competition among financial services providers in our principal service area. Our competitors may have greater resources, higher lending limits, or larger branch systems than we do. Accordingly, they may be able to offer a broader range of products and services as well as better pricing for those products and services than we can.

In addition, some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on federally insured financial institutions. As a result, those non-bank competitors may be able to access funding and provide various services more easily or at less cost than we can, adversely affecting our ability to compete effectively.

The value of certain investment securities is volatile and future declines or other-than-temporary impairments could materially adversely affect our future earnings and regulatory capital.

Continued volatility in the market value for certain of our investment securities, whether caused by changes in market perceptions of credit risk, as reflected in the expected market yield of the security, or actual defaults in the portfolio could result in significant fluctuations in the value of the securities. This could have a material adverse impact on our accumulated other comprehensive income/loss and shareholders’ equity depending on the direction of the fluctuations. Furthermore, future downgrades or defaults in these securities could result in future classifications of investment securities as other than temporarily impaired. This could have a material impact on our future earnings.

We may be adversely affected by government regulation.

The banking industry is heavily regulated. Banking regulations are primarily intended to protect the federal deposit insurance funds and depositors, not shareholders. Changes in the laws, regulations, and regulatory practices affecting the banking industry may increase our costs of doing business or otherwise adversely affect us and create competitive advantages for others. Regulations affecting banks and financial services companies undergo continuous change, and we cannot predict the ultimate effect of these changes, which could have a material adverse effect on our profitability or financial condition.

In response to the financial crisis that commenced in 2008, Congress has taken actions that are intended to strengthen confidence and encourage liquidity in financial institutions, and the FDIC has taken actions to increase insurance coverage on deposit accounts. The Dodd-Frank Act provides for the creation of a consumer protection division at the Board of Governors of the Federal Reserve System that will have broad authority to issue regulations governing the services and products we provide consumers. This additional regulation could increase our compliance costs and otherwise adversely impact our operations. That legislation also contains provisions that, over time, could result in higher regulatory capital requirements (including through the implementation of the capital standards of Basel III) and loan loss provisions for the Banks, and may increase interest expense due to the ability granted in July 2011 to pay interest on all demand deposits. In addition, there have been proposals made by members of Congress and others that would reduce the amount delinquent borrowers are otherwise contractually obligated to pay under their mortgage loans and limit an institution's ability to foreclose on mortgage collateral. These proposals could result in credit losses or increased expense in pursuing our remedies as a creditor. Recent regulatory changes impose limits on our ability to charge overdraft fees, which may decrease our non-interest income as compared to more recent prior periods.

The potential exists for additional federal or state laws and regulations, or changes in policy, affecting many aspects of our operations, including capital levels, lending and funding practices, and liquidity standards. New laws and regulations may increase our costs of regulatory compliance and of doing business and otherwise affect our operations, and may significantly affect the markets in which we do business, the markets for and value of our loans and investments, the fees we can charge and our ongoing operations, costs and profitability.

We rely on our management and other key personnel, and the loss of any of them may adversely affect our operations.

We are and will continue to be dependent upon the services of our executive management team. In addition, we will continue to depend on our ability to retain and recruit key commercial loan officers. The unexpected loss of services of any key management personnel or commercial loan officers could have an adverse effect on our business and financial condition because of their skills, knowledge of our market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel.

Environmental liability associated with lending activities could result in losses.

In the course of our business, we may foreclose on and take title to properties securing our loans. If hazardous substances were discovered on any of these properties, we could be liable to governmental entities or third parties for the costs of remediation of the hazard, as well as for personal injury and property damage. Many environmental laws can impose liability regardless of whether we knew of, or were responsible for, the contamination. In addition, if we arrange for the disposal of hazardous or toxic substances at another site, we may be liable for the costs of cleaning up and removing those substances from the site even if we neither own nor operate the disposal site. Environmental laws may require us to incur substantial expenses and may materially limit use of properties we acquire through foreclosure, reduce their value or limit our ability to sell them in the event of a default on the loans they secure. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability.

Failure to implement new technologies in our operations may adversely affect our growth or profits.

The market for financial services, including banking services and consumer finance services is increasingly affected by advances in technology, including developments in telecommunications, data processing, computers, automation, Internet-based banking, and telebanking. Our ability to compete successfully in our markets may depend on the extent to which we are able to exploit such technological changes. However, we can provide no assurance that we will be able to properly or timely anticipate or implement such technologies or properly train our staff to use such technologies. Any failure to adapt to new technologies could adversely affect our business, financial condition, or operating results.

An investment in our common stock is not an insured deposit.

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, or by any other public or private entity. Investment in our common stock is subject to the same market forces that affect the price of common stock in any company.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

The Company owns and leases its properties. Listed herewith are the locations of properties owned or leased as of December 31, 2016, in which the banking offices are located; all properties are in good condition and adequate for the Company's purposes:

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Jersey Shore State Bank & Subsidiaries

Office	Address	Ownership
Main Street	115 South Main Street, PO Box 5098 Jersey Shore, Pennsylvania 17740	Owned
Bridge Street	112 Bridge Street Jersey Shore, Pennsylvania 17740	Owned
DuBoistown	2675 Euclid Avenue Williamsport, Pennsylvania 17702	Owned
Williamsport	300 Market Street P.O. Box 967 Williamsport, Pennsylvania 17703-0967	Owned
Montgomery	9094 Rt. 405 Highway Montgomery, Pennsylvania 17752	Owned
Lock Haven	4 West Main Street Lock Haven, Pennsylvania 17745	Owned
Mill Hall	(Inside Wal-Mart), 173 Hogan Boulevard Mill Hall, Pennsylvania 17751	Under Lease
Spring Mills	3635 Penns Valley Road, P.O. Box 66 Spring Mills, Pennsylvania 16875	Under Lease
Centre Hall	2842 Earlystown Road Centre Hall, Pennsylvania 16828	Land Under Lease
Zion	100 Cobblestone Road Bellefonte, Pennsylvania 16823	Under Lease
State College	2050 North Atherton Street State College, Pennsylvania 16803	Land Under Lease
Montoursville	820 Broad Street Montoursville, Pennsylvania 17754	Under Lease
Danville	606 Continental Boulevard Danville, Pennsylvania 17821	Under Lease
Loyalsock	1720 East Third Street Williamsport, PA 17701	Owned
Lewisburg	550 North Derr Drive Lewisburg, PA 17837	Land Under Lease
The M Group, Inc.	705 Washington Boulevard	Under Lease

D/B/A The Comprehensive Financial Group Williamsport, Pennsylvania 17701

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Luzerne Bank

Office	Address	Ownership
Dallas	509 Main Road Memorial Highway Dallas, PA 18612	Owned
Lake	Corners of Rt. 118 & 415 Dallas, PA 18612	Owned
Hazle Twp.	10 Dessen Drive Hazle Twp., PA 18202	Owned
Luzerne	118 Main Street Luzerne, PA 18709	Owned
Plains	1077 Hwy. 315 Wilkes Barre, PA 18702	Under Lease
Swoyersville	801 Main Street Swoyersville, PA 18704	Owned
Wilkes-Barre	67 Public Square Wilkes-Barre, PA 18701	Under Lease
Wyoming	324 Wyoming Ave. Wyoming, PA 18644	Owned

ITEM 3 LEGAL PROCEEDINGS

The Company is subject to lawsuits and claims arising out of its business in the ordinary course. In the opinion of management, after review and consultation with counsel, there are no legal proceedings currently pending or threatened that are reasonably likely to have a material adverse effect on the consolidated financial position or results of operations of the Company.

ITEM 4 MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

The Company's common stock is listed on the NASDAQ Global Select Market under the symbol "PWOD". The following table sets forth (1) the quarterly high and low closing sale prices for a share of the Company's Common Stock during the periods indicated, and (2) quarterly dividends on a share of the common stock with respect to each quarter since January 1, 2014.

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	Price Range		Dividends
	High	Low	Declared
2016			
First quarter	$41.32	$36.73	$ 0.47
Second quarter	44.70	37.82	0.47
Third quarter	44.75	40.34	0.47
Fourth quarter	52.03	41.00	0.47
2015			
First quarter	$48.91	$44.41	$ 0.47
Second quarter	48.28	41.84	0.47
Third quarter	44.56	40.41	0.47
Fourth quarter	45.28	40.47	0.47
2014			
First quarter	$50.95	$43.19	$ 0.47
Second quarter	48.37	43.21	0.47
Third quarter	48.79	42.25	0.47
Fourth quarter	49.26	42.18	0.47

The Company has paid dividends since the effective date of its formation as a bank holding company. It is the present intention of the Company's board of directors to continue the dividend payment policy; however, further dividends must necessarily depend upon earnings, financial condition, appropriate legal restrictions, and other factors relevant at the time the board of directors of the Company considers dividend policy. Cash available for dividend distributions to shareholders of the Company primarily comes from dividends paid by Jersey Shore State Bank and Luzerne Bank to the Company. Therefore, the restrictions on the Banks' dividend payments are directly applicable to the Company. See also the information appearing in Note 20 to "Notes to Consolidated Financial Statements" for additional information related to dividend restrictions.

Under the Pennsylvania Business Corporation Law of 1988 a corporation may not pay a dividend, if after giving effect thereto, the corporation would be unable to pay its debts as they become due in the usual course of business and after giving effect thereto the total assets of the corporation would be less than the sum of its total liabilities plus the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of the shareholders whose preferential rights are superior to those receiving the dividend.

As of March 1, 2017, the Company had approximately 1,317 shareholders of record.

Following is a schedule of the shares of the Company's common stock purchased by the Company during the fourth quarter of 2016.

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Units) Purchased	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1 (October 1 - October 31, 2016)	—	$ ——		390,144
Month #2 (November 1 - November 30, 2016)	—	—	—	390,144
Month #3 (December 1 - December 31, 2016)	—	—	—	390,144

Set forth below is a line graph comparing the yearly dollar changes in the cumulative shareholder return on the Company's common stock against the cumulative total return of the S&P 500 Stock Index, NASDAQ Bank Index,

NASDAQ Composite, Russell 2000, and SNL U.S. Bank NASDAQ for the period of five fiscal years assuming the investment of $100.00 on December 31, 2011 and assuming the reinvestment of dividends. The shareholder return shown on the graph below is not necessarily indicative of future performance.

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Index	Period Ending 12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Penns Woods Bancorp, Inc.	100.00	101.28	144.89	145.77	131.18	162.89
S&P 500	100.00	116.00	153.57	174.60	177.01	198.18
NASDAQ Composite	100.00	117.45	164.57	188.84	201.98	219.89
NASDAQ Bank	100.00	118.69	168.21	176.48	192.08	265.02
Russell 2000	100.00	116.35	161.52	169.43	161.95	196.45
SNL U.S. Bank NASDAQ	100.00	119.19	171.31	177.42	191.53	265.56

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ITEM 6 SELECTED FINANCIAL DATA

The following table sets forth certain financial data for each of the years in the five-year period ended December 31, 2016:

(In Thousands, Except Per Share Data Amounts)	2016	2015	2014	2013	2012
Consolidated Statement of Income Data:					
Interest income	$46,813	$46,124	$45,606	$43,299	$37,107
Interest expense	5,567	5,219	4,962	5,264	6,211
Net interest income	41,246	40,905	40,644	38,035	30,896
Provision for loan losses	1,196	2,300	2,850	2,275	2,525
Net interest income after provision for loan losses	40,050	38,605	37,794	35,760	28,371
Non-interest income	12,113	12,765	14,508	12,042	10,100
Non-interest expense	35,091	33,736	33,890	30,267	22,023
Income before income tax provision	17,072	17,634	18,412	17,535	16,448
Income tax provision	4,597	3,736	3,804	3,451	2,598
Net income	$12,475	$13,898	$14,608	$14,084	$13,850
Consolidated Balance Sheet at End of Period:					
Total assets	$1,348,590	$1,320,057	$1,245,011	$1,211,995	$856,535
Loans	1,093,681	1,045,207	915,579	818,344	512,232
Allowance for loan losses	(12,896)	(12,044)	(10,579)	(10,144)	(7,617)
Deposits	1,095,214	1,031,880	981,419	973,002	642,026
Long-term debt	85,998	91,025	71,176	71,202	76,278
Shareholders’ equity	138,249	136,279	135,967	127,815	93,726
Per Share Data:					
Earnings per share - basic	$2.64	$2.91	$3.03	$3.19	$3.61
Earnings per share - diluted	2.64	2.91	3.03	3.19	3.61
Cash dividends declared	1.88	1.88	1.88	2.13	1.88
Book value	29.20	28.71	28.30	26.52	24.42
Number of shares outstanding, at end of period	4,734,657	4,747,132	4,804,815	4,819,333	3,838,516
Weighted average number of shares outstanding - basic and diluted	4,735,457	4,772,239	4,816,149	4,410,626	3,837,751
Selected Financial Ratios:					
Return on average shareholders’ equity	8.96%	10.11%	10.79%	12.36%	15.36%
Return on average total assets	0.93%	1.08%	1.19%	1.32%	1.70%
Net interest margin	3.44%	3.61%	3.81%	4.13%	4.45%
Dividend payout ratio	71.37%	64.52%	61.99%	67.88%	52.08%
Average shareholders’ equity to average total assets	10.38%	10.68%	11.05%	10.70%	11.04%
Loans to deposits, at end of period	99.86%	101.29%	93.29%	84.11%	79.78%

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ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

RESULTS OF OPERATIONS

NET INTEREST INCOME

Net interest income is determined by calculating the difference between the yields earned on interest-earning assets and the rates paid on interest-bearing liabilities. To compare the tax-exempt asset yields to taxable yields, amounts are adjusted to taxable equivalents based on the marginal corporate federal tax rate of 34%. The tax equivalent adjustments to net interest income for 2016, 2015, and 2014 were $1,402,000, $2,011,000, and $2,219,000, respectively.

2016 vs. 2015

Reported net interest income increased $341,000 to $41,246,000 for the year ended December 31, 2016 compared to the year ended December 31, 2015, as the growth in the earning asset portfolio offset the impact of the yield on earning assets decreasing to 3.88% from 4.04%. Total interest income increased $689,000 as the impact of growth in the average balance of the loan portfolio was limited by a decline in the average balance of the investment portfolio as the portfolio is actively managed to reduce interest rate and market risk. Interest income on a tax equivalent basis recognized on the loan portfolio increased $2,981,000 due to a $81,592,000 increase in the average balance in the loan portfolio. Interest and dividend income generated from the investment portfolio on a tax equivalent basis decreased $3,076,000 due to a $61,820,000 decrease in the average balance in the investment portfolio and a 40 basis point ("bp") reduction in the average rate. The decrease in the portfolio was driven by a strategic plan that started in 2014 to sell off long-term municipal bonds with a maturity date greater than 10 years and securities with a call date within the next five years, in order to reduce interest rate risk and market risk.

Interest expense increased $348,000 to $5,567,000 for the year ended December 31, 2016 compared to 2015. The increase in interest expense was driven by growth in total deposits and borrowings that funded the earning asset portfolio growth. The impact of the growth in interest-bearing liabilities was limited by minimal increase of 2 bp in cost of funds. The average rate paid on time deposits increased 16 bp as the time deposit portfolio was lengthened in preparation for a rising rate environment.

2015 vs. 2014

Reported net interest income increased $261,000 to $40,905,000 for the year ended December 31, 2015 compared to the year ended December 31, 2014, as the yield on earning assets decreased to 4.04% from 4.25% offsetting the growth in the earning asset portfolio. On a tax equivalent basis, the change in net interest income was an increase of $53,000 to $42,916,000 for the year ended December 31, 2015 compared to the year ended December 31, 2014. Total interest income increased $518,000 as the impact of growth in the average balance of the loan portfolio was limited by a decline in the average balance of the investment portfolio as the portfolio is actively managed to reduce interest rate and market risk. Interest income growth was also limited by the portfolio yields caused by the prolonged low interest rate cycle enacted by the Federal Open Markets Committee ("FOMC"). Interest income on a tax equivalent basis recognized on the loan portfolio increased $2,770,000 due to a $117,317,000 increase in the average balance in the loan portfolio which was partially offset by interest rates repricing downward . Interest and dividend income generated from the investment portfolio on a tax equivalent basis decreased $2,440,000 due to a $46,232,000 decrease in the average balance in the investment portfolio and a 23 basis point ("bp") reduction in the average rate. The decrease in the portfolio was driven by a strategic plan that started in 2014 to sell off long-term municipal bonds with a maturity date of 2025 or later and securities with a call date within the next five years, in order to reduce interest rate

risk and market risk.

Interest expense increased $257,000 to $5,219,000 for the year ended December 31, 2015 compared to 2014. The increase in interest expense was driven by growth in total deposits and borrowings that funded the earning asset portfolio growth. The impact of the growth in interest-bearing liabilities was limited by minimal increase of 1 bp in cost of funds. The average rate paid on time deposits increased 13 bp as efforts were undertaken to lengthen the time deposit portfolio in preparation for a rising rate environment.

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AVERAGE BALANCES AND INTEREST RATES

The following tables set forth certain information relating to the Company's average balance sheet and reflect the average yield on assets and average cost of liabilities for the periods indicated and the average yields earned and rates paid. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods presented.

	2016				2015				2014			
(In Thousands)	Average Balance	Interest	Average Rate		Average Balance	Interest	Average Rate		Average Balance	Interest	Average Rate	
Assets:												
Tax-exempt loans	$47,782	$1,852	3.87	%	$43,395	$1,679	3.87	%	$29,461	$1,295	4.40	%
All other loans	1,009,384	40,834	4.05	%	932,179	38,026	4.08	%	828,796	35,640	4.30	%
Total loans	1,057,166	42,686	4.04	%	975,574	39,705	4.07	%	858,257	36,935	4.30	%
Fed funds sold	—	—	—	%	—	—	—	%	170	—	—	%
Taxable securities	94,887	3,072	3.24	%	127,052	4,183	3.29	%	161,889	5,626	3.48	%
Tax-exempt securities	53,638	2,270	4.23	%	83,293	4,235	5.08	%	94,688	5,232	5.53	%
Total securities	148,525	5,342	3.60	%	210,345	8,418	4.00	%	256,577	10,858	4.23	%
Interest-bearing deposits	36,592	187	0.51	%	4,238	12	0.28	%	9,318	32	0.34	%
Total interest-earning assets	1,242,283	48,215	3.88	%	1,190,157	48,135	4.04	%	1,124,322	47,825	4.25	%
Other assets	99,500				97,103				100,983			
Total assets	$1,341,783				$1,287,260				$1,225,305			
Liabilities and shareholders' equity:												
Savings	$151,397	58	0.04	%	$143,055	56	0.04	%	$140,575	81	0.06	%
Super Now deposits	187,106	458	0.24	%	187,396	491	0.26	%	182,229	583	0.32	%
Money market deposits	238,175	648	0.27	%	207,252	554	0.27	%	210,066	561	0.27	%
Time deposits	221,498	2,383	1.08	%	220,360	2,028	0.92	%	223,537	1,770	0.79	%
Total interest-bearing deposits	798,176	3,547	0.44	%	758,063	3,129	0.41	%	756,407	2,995	0.40	%
Short-term borrowings	18,518	46	0.25	%	38,909	116	0.30	%	22,342	54	0.24	%
Long-term borrowings	90,554	1,974	2.14	%	84,721	1,974	2.30	%	71,195	1,913	2.65	%
Total borrowings	109,072	2,020	1.82	%	123,630	2,090	1.67	%	93,537	1,967	2.07	%

Total interest-bearing liabilities	907,248	5,567	0.61	%	881,693	5,219	0.59	%	849,944	4,962	0.58	%
Demand deposits	279,130				251,029				225,981			
Other liabilities	16,152				17,047				13,933			
Shareholders' equity	139,253				137,491				135,447			
Total liabilities and shareholders' equity	$1,341,783				$1,287,260				$1,225,305			
Interest rate spread			3.27	%			3.45	%			3.67	%
Net interest income/margin		$42,648	3.44	%		$42,916	3.61	%		$42,863	3.81	%

· Fees on loans are included with interest on loans as follows: 2016 - $873,000; 2015 - $422,000; 2014 - $487,000.

· Information in this table has been calculated using average daily balance sheets to obtain average balances.

· Nonaccrual loans have been included with loans for the purpose of analyzing net interest earnings.

· Income and rates on a fully taxable equivalent basis include an adjustment for the difference between annual income from tax-exempt obligations and the taxable equivalent of such income at the standard 34% tax rate.

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Reconciliation of Taxable Equivalent Net Interest Income

(In Thousands)	2016	2015	2014
Total interest income	$46,813	$46,124	$45,606
Total interest expense	5,567	5,219	4,962
Net interest income	41,246	40,905	40,644
Tax equivalent adjustment	1,402	2,011	2,219
Net interest income (fully taxable equivalent)	$42,648	$42,916	$42,863

Rate/Volume Analysis

The table below sets forth certain information regarding changes in our interest income and interest expense for the periods indicated. For interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (changes in average volume multiplied by old rate) and (ii) changes in rates (changes in rate multiplied by old average volume). Increases and decreases due to both interest rate and volume, which cannot be separated, have been allocated proportionally to the change due to volume and the change due to interest rate. Income and interest rates are on a taxable equivalent basis.

	Year Ended December 31,					
	2016 vs. 2015			2015 vs. 2014		
	Increase (Decrease) Due To			Increase (Decrease) Due To		
(In Thousands)	Volume	Rate	Net	Volume	Rate	Net
Interest income:						
Loans, tax-exempt	$173	$—	$173	$555	$(171)	$384
Loans	3,093	(285)	2,808	4,278	(1,892)	2,386
Taxable investment securities	(1,048)	(63)	(1,111)	(1,151)	(292)	(1,443)
Tax-exempt investment securities	(1,338)	(627)	(1,965)	(595)	(402)	(997)
Interest-bearing deposits	91	84	175	(22)	3	(19)
Total interest-earning assets	971	(891)	80	3,065	(2,754)	311
Interest expense:						
Savings deposits	4	(2)	2	—	(2)	(2)
Super Now deposits	(1)	(32)	(33)	17	(109)	(92)
Money market deposits	90	4	94	(7)	—	(7)
Time deposits	11	344	355	(27)	285	258
Short-term borrowings	(52)	(18)	(70)	47	15	62
Long-term borrowings	133	(133)	—	330	(269)	61
Total interest-bearing liabilities	185	163	348	360	(80)	280
Change in net interest income	$786	$(1,054)	$(268)	$2,705	$(2,674)	$31

PROVISION FOR LOAN LOSSES

2016 vs 2015

The provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Company. Management remains committed to an aggressive program of problem loan identification and resolution.

The allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management's consideration of the nature of the portfolio segments, changes in mix and volume of the loan portfolio, and historical loan loss experience. In addition, management considers industry standards and trends with respect to nonperforming loans and its knowledge and experience with specific lending segments.

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Although management believes that it uses the best information available to make such determinations and that the allowance for loan losses is adequate at December 31, 2016, future adjustments could be necessary if circumstances or economic conditions differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy or employment and delays in receiving financial information from borrowers could result in increased levels of nonperforming assets and charge-offs, increased loan loss provisions and reductions in interest income. Additionally, as an integral part of the examination process, bank regulatory agencies periodically review the Banks' loan loss allowance adequacy. The banking regulators could require the recognition of additions to the loan loss allowance based on their judgment of information available to them at the time of their examination.

While determining the appropriate allowance level, management has attributed the allowance for loan losses to various portfolio segments; however, the allowance is available for the entire portfolio as needed.

The allowance for loan losses increased from $12,044,000 at December 31, 2015 to $12,896,000 at December 31, 2016. At December 31, 2016, the allowance for loan losses was 1.18% of total loans compared to 1.15% of total loans at December 31, 2015.

The provision for loan losses totaled $1,196,000 for the year ended December 31, 2016 compared to $2,300,000 for the year ended December 31, 2015. The decrease in the provision was appropriate when considering the gross loan growth and low level of net charge-offs during 2016. Net charge-offs of $344,000 represented 0.03% of average loans for the year ended December 31, 2016 compared to net charge-offs of $835,000 or 0.09% of average loans for the year ended December 31, 2015. The growth in the loan portfolio was driven by home equity product growth which historically is a lower risk product than commercial loans and requires a lower allowance for loan losses. While nonperforming loans increased, the majority of the nonperforming loans are centered on several loans that are either in a secured position and have sureties with a strong underlying financial position and/or a specific allowance within the allowance for loan losses. Internal loan review and analysis, coupled with the ratios noted previously, dictated a decrease in the provision for loan losses. Utilizing both internal and external resources, as noted, senior management has concluded that the allowance for loan losses remains at a level adequate to provide for probable losses inherent in the loan portfolio.

2015 vs 2014

The allowance for loan losses increased from $10,579,000 at December 31, 2014 to $12,044,000 at December 31, 2015. At December 31, 2015, the allowance for loan losses was 1.15% of total loans compared to 1.16% of total loans at December 31, 2014.

The provision for loan losses totaled $2,300,000 for the year ended December 31, 2015 compared to $2,850,000 for the year ended December 31, 2014. The decrease in the provision was appropriate when considering the gross loan growth offset by the $2,802,000 or 22.88% decrease in non-performing loans and level of net charge-offs. Net charge-offs of $835,000 represented 0.09% of average loans for the year ended December 31, 2015 compared to net charge-offs of $2,451,000 or 0.28% of average loans for the year ended December 31, 2014. The growth in the loan portfolio was driven by home equity product growth which historically is a lower risk product than commercial loans and requires a lower allowance for loan losses. The decrease in nonperforming loans is primarily the result of the payoff of a large commercial real estate loan and the resolution of several smaller commercial real estate loans. The majority of the nonperforming loans are centered on several loans that are either in a secured position and have sureties with a strong underlying financial position and/or a specific allowance within the allowance for loan losses. Internal loan review and analysis, coupled with the ratios noted previously, dictated a decrease in the provision for loan losses. Utilizing both internal and external resources, as noted, senior management has concluded that the allowance for loan losses remains at a level adequate to provide for probable losses inherent in the loan portfolio.

NON-INTEREST INCOME

2016 vs. 2015

Total non-interest income decreased $652,000 from the year ended December 31, 2015 to December 31, 2016. Excluding net security gains, non-interest income increased $249,000 year over year. Service charges decreased due to decreased level of overdraft income. Bank owned life insurance income decreased due to decrease in the earnings rate. Insurance commissions and brokerage commissions increased in part due to the book of business that was purchased in 2016. Gain on sale of loans increased due to a shift product mix that began in the latter part of 2015 and the addition of mortgage loan originators. The decrease in other income was primarily from an increased level of debit card income.

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(In Thousands)	2016 Amount	% Total	2015 Amount	% Total	Change Amount	%
Service charges	$2,249	18.57 %	$2,383	18.67 %	$(134)	(5.62)%
Net securities gains, available for sale	1,611	13.30	2,592	20.31	(981)	(37.85)
Net securities gains (losses), trading	58	0.48	(22)	(0.17)	80	363.64
Bank owned life insurance	684	5.65	720	5.64	(36)	(5.00)
Gain on sale of loans	2,102	17.35	1,743	13.65	359	20.60
Insurance commissions	795	6.56	781	6.12	14	1.79
Brokerage commissions	1,098	9.06	1,064	8.34	34	3.20
Other	3,516	29.03	3,504	27.44	12	0.34
Total non-interest income	$12,113	100.00%	$12,765	100.00 %	$(652)	(5.11)%

2015 vs. 2014

Total non-interest income decreased $1,743,000 from the year ended December 31, 2014 to December 31, 2015. Excluding net security gains, non-interest income decreased $798,000 year over year. Service charges decreased slightly due to decreased level of overdraft income. Bank owned life insurance income decreased as a gain on death benefit was recognized in 2014. Insurance commissions and brokerage commissions decreased due to a shift in product mix and a decreased level of commissions received on each sale. Gain on sale of loans decreased due to product mix. The decrease in other income was primarily from a decreased level of debit card income.

(In Thousands)	2015 Amount	% Total	2014 Amount	% Total	Change Amount	%
Service charges	$2,383	18.67 %	$2,419	16.67 %	$(36)	(1.49)%
Net securities gains, available for sale	2,592	20.31	3,515	24.23	(923)	(26.26)
Net securities losses, trading	(22)	(0.17)	—	—	(22)	N/A
Bank owned life insurance	720	5.64	923	6.36	(203)	(21.99)
Gain on sale of loans	1,743	13.65	1,803	12.43	(60)	(3.33)
Insurance commissions	781	6.12	1,146	7.90	(365)	(31.85)
Brokerage commissions	1,064	8.34	1,077	7.42	(13)	(1.21)
Other	3,504	27.44	3,625	24.99	(121)	(3.34)
Total non-interest income	$12,765	100.00 %	$14,508	100.00%	$(1,743)	(12.01)%

NON-INTEREST EXPENSE

2016 vs. 2015

Total non-interest expenses increased $1,355,000 from the year ended December 31, 2015 to December 31, 2016. The increase in salaries and employee benefits was attributable to increased health insurance expense and annual wage increases. Furniture and equipment expenses increased due to the continued enhancement of systems. Amortization of investment in limited partnerships decreased as two investments were fully amortized during 2016. The increase in marketing expense was primarily related to the home equity and time deposit campaigns conducted during 2016. Other expenses were impacted by a mass replacement of debit cards to implement EMV card technology to better protect the security of our customers. In addition, expenses increased due to a data breach at a national restaurant chain that impacted our customer base.

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(In Thousands)	2016 Amount	% Total	2015 Amount	% Total	Change Amount	%
Salaries and employee benefits	$17,813	50.76 %	$17,023	50.46 %	$790	4.64 %
Occupancy	2,223	6.33	2,248	6.66	(25)	(1.11)
Furniture and equipment	2,793	7.96	2,622	7.77	171	6.52
Pennsylvania shares tax	873	2.49	954	2.83	(81)	(8.49)
Amortization of investment in limited partnerships	312	0.89	661	1.96	(349)	(52.80)
FDIC deposit insurance	767	2.19	867	2.57	(100)	(11.53)
Marketing	740	2.11	612	1.81	128	20.92
Intangible amortization	366	1.04	311	0.92	55	17.68
Other	9,204	26.23	8,438	25.02	766	9.08
Total non-interest expense	$35,091	100.00%	$33,736	100.00%	$1,355	4.02 %

2015 vs. 2014

Total non-interest expenses decreased $154,000 from the year ended December 31, 2014 to December 31, 2015. The decrease in salaries and employee benefits was attributable to the defined benefit pension plan ceasing to accrue additional benefits as of December 31, 2014. Furniture and equipment expenses increased due to the full year impact of significant upgrades to the core operating system, a new teller system, and various enhancements to other ancillary systems that were undertaken during 2014. Other expenses decreased as the acquisition of Luzerne Bank is allowing for greater purchasing power as various contracts are renewed.

(In Thousands)	2015 Amount	% Total	2014 Amount	% Total	Change Amount	%
Salaries and employee benefits	$17,023	50.46 %	$17,273	50.97 %	$(250)	(1.45)%
Occupancy	2,248	6.66	2,301	6.79	(53)	(2.30)
Furniture and equipment	2,622	7.77	2,536	7.48	86	3.39
Pennsylvania shares tax	954	2.83	907	2.68	47	5.18
Amortization of investment in limited partnerships	661	1.96	661	1.95	—	—
FDIC deposit insurance	867	2.57	746	2.20	121	16.22
Marketing	612	1.81	532	1.57	80	15.04
Intangible amortization	311	0.92	345	1.02	(34)	—
Other	8,438	25.02	8,589	25.34	(151)	(1.76)
Total non-interest expense	$33,736	100.00%	$33,890	100.00%	$(154)	(0.45)%

INCOME TAXES

2016 vs. 2015

The provision for income taxes for the year ended December 31, 2016 resulted in an effective income tax rate of 26.93% compared to 21.19% for 2015. This increase is primarily the result of decreased tax-exempt investment income and bank-owned life insurance income which has resulted in a greater percentage of the pre-tax income being taxable.

The Company currently is in a deferred tax asset position. Management has reviewed the deferred tax asset and has determined that the asset will be utilized within the appropriate carry forward period and therefore does not require a valuation allowance.

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2015 vs. 2014

The provision for income taxes for the year ended December 31, 2015 resulted in an effective income tax rate of 21.19% compared to 20.66% for 2014. This increase is primarily the result of decreased tax-exempt investment income and bank-owned life insurance income which has resulted in a greater percentage of the pre-tax income being taxable.

FINANCIAL CONDITION

INVESTMENTS

2016

The fair value of the investment portfolio decreased $42,680,000 from December 31, 2015 to December 31, 2016. The decrease in value is the result of the investment portfolio being actively managed in order to reduce interest rate and market risk. This process began in 2014 and is being undertaken primarily through the sale of long term municipal bonds that have a maturity date greater than ten years and securities with a call date within the next five years. In addition, the decrease in corporate bond holdings is being undertaken to reduce risk and also in response to the changes in bank regulatory capital calculations per Basel III. The proceeds of the bond sales are primarily being deployed into loans. The strategy to sell a portion of the long-term bond portfolio does negatively impact current earnings, but this action plays a key role in our long-term asset/liability management strategy as the balance sheet is shortened to better prepare for a rising rate environment. The unrealized losses within the debt securities portfolio are the result of market activity, not credit issues/ratings, as approximately 88% of the debt securities portfolio on an amortized cost basis is currently rated A or higher by either S&P or Moody's.

2015

The fair value of the investment portfolio decreased $55,983,000 from December 31, 2014 to December 31, 2015. The decrease in value is the result of the investment portfolio being actively managed in order to reduce interest rate and market risk. This process began in 2014 and is being undertaken primarily through the sale of long term municipal bonds that have a maturity date of 2025 or later and securities with a call date within the next five years. In addition, the decrease in corporate bond holdings is being undertaken to reduce risk and also in response to the changes in bank regulatory capital calculations per Basel III. The proceeds of the bond sales are primarily being deployed into loans. The strategy to sell a portion of the long-term bond portfolio does negatively impact current earnings, but this action plays a key role in our long-term asset/liability management strategy as the balance sheet is shortened to better prepare for a rising rate environment. The unrealized losses within the debt securities portfolio are the result of market activity, not credit issues/ratings, as approximately 90% of the debt securities portfolio on an amortized cost basis is currently rated A or higher by either S&P or Moody's.

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The carrying amounts of investment securities are summarized as follows for the years ended December 31, 2016 and 2015:

(In Thousands)	2016 Balance	% Portfolio	2015 Balance	% Portfolio	2014 Balance	% Portfolio
U.S. Government agency securities:						
Available for sale	$—	— %	$3,549	2.01 %	3,841	1.65 %
Mortgage-backed securities:						
Available for sale	9,313	6.97	10,009	5.68	12,697	5.47
Asset-backed securities:						
Available for sale	109	0.08	1,940	1.10	2,492	1.07
State and political securities (tax-exempt):						
Available for sale	45,506	34.08	73,110	41.49	89,024	38.34
State and political securities (taxable):						
Available for sale	15,428	11.55	13,445	7.63	19,092	8.22
Other bonds, notes and debentures:						
Available for sale	51,118	38.28	57,772	32.78	89,463	38.53
Total bonds, notes and debentures	121,474	90.96	159,825	90.69	216,609	93.28
Financial institution equity securities:						
Available for sale	10,535	7.89	11,483	6.52	9,915	4.27
Other equity securities:						
Available for sale	1,483	1.11	4,849	2.75	5,689	2.45
Trading	58	0.04	73	0.04	—	—
Total equity securities	12,076	9.04	16,405	9.31	15,604	6.72
Total	$133,550	100.00 %	$176,230	100.00 %	$232,213	100.00 %

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The following table shows the maturities and repricing of investment securities, at amortized cost and the weighted average yields (for tax-exempt obligations on a fully taxable basis assuming a 34% tax rate) at December 31, 2016:

(In Thousands)	Three Months or Less	Over Three Months Through One Year	Over One Year Through Five Years	Over Five Years Through Ten Years	Over Ten Years	Amortized Cost Total
U.S. Government agency securities:						
AFS Amount	$—	$—	$—	$—	$—	$—
Yield	— %	— %	— %	— %	— %	— %
Mortgage-backed securities:						
AFS Amount	—	—	6,028	—	3,267	9,295
Yield	— %	— %	2.33 %	— %	3.45 %	2.72 %
Asset-backed securities:						
AFS Amount	—	109	—	—	—	109
Yield	— %	1.16 %	— %	— %	— %	1.16 %
State and political securities (tax-exempt):						
AFS Amount	1,596	8,000	18,435	17,113	418	45,562
Yield	4.18 %	3.65 %	2.30 %	2.30 %	2.40 %	2.60 %
State and political securities (taxable):						
AFS Amount	—	—	6,915	8,300	—	15,215
Yield	— %	— %	4.46 %	3.54 %	— %	3.96 %
Other bonds, notes, and debentures:						
AFS Amount	346	—	21,836	30,864	—	53,046
Yield	3.75 %	— %	3.01 %	2.61 %	— %	2.78 %
Total Amount	$1,942	$8,109	$53,214	$56,277	$3,685	123,227
Total Yield	4.10 %	3.61 %	2.88 %	2.65 %	3.33 %	2.86 %
Equity Securities						
AFS Amount						11,233
Trading Amount						56
Total Investment Portfolio Value						$134,516
Total Investment Portfolio Yield						2.62 %

All yields represent weighted average yields expressed on a tax equivalent basis. They are calculated on the basis of the cost, adjusted for amortization of premium and accretion of discount, and effective yields weighted for the scheduled maturity of each security. The taxable equivalent adjustment represents the difference between annual income from tax-exempt obligations and the taxable equivalent of such income at the standard 34% tax rate (derived by dividing tax-exempt interest by 66%).

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The distribution of credit ratings by amortized cost and estimated fair value for the debt security portfolio at December 31, 2016 follows:

(In Thousands)	A- to AAA		B- to BBB+		C to CCC+		Not Rated		Total	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale										
U.S. Government and agency securities	$—	$—	$—	$—	$ —	$ —	$—	$—	$—	$—
Mortgage-backed securities	9,295	9,313	—	—	—	—	—	—	9,295	9,313
Asset-backed securities	109	109	—	—	—	—	—	—	109	109
State and political securities	59,252	59,406	—	—	—	—	1,525	1,528	60,777	60,934
Other debt securities	39,643	38,472	13,403	12,646	—	—	—	—	53,046	51,118
Total debt securities	$108,299	$107,300	$13,403	$12,646	$ —	$ —	$1,525	$1,528	$123,227	$121,474

LOAN PORTFOLIO

2016

Gross loans of $1,093,681,000 at December 31, 2016 represented an increase of $48,474,000 from December 31, 2015. The continued emphasis on well collateralized real estate loans was the primary driver of the overall increase in loans outstanding, with home equity loans and lines of credit leading the way. The emphasis to add home equity lines of credit is part of the overall strategy to shorten the duration of the earning asset portfolio in preparation of a rising interest rate environment. Indirect auto lending was introduced during the latter portion of 2016 and contributed to the increase in installment loans to individuals.

2015

Gross loans of $1,045,207,000 at December 31, 2015 represented an increase of $129,628,000 from December 31, 2014. The continued emphasis on well collateralized real estate loans was the primary driver of the overall increase in loans outstanding, with home equity loans and lines of credit leading the way. The emphasis to add home equity lines of credit is part of the overall strategy to shorten the duration of the earning asset portfolio in preparation of a rising interest rate environment. Several successful campaigns to increase home equity, multifamily residential, and auto loans were undertaken during 2015 with the increase in residential and commercial loans being directly correlated to the campaigns.

The amounts of loans outstanding at the indicated dates are shown in the following table according to type of loan at December 31, 2016, 2015, 2014, 2013, and 2012:

(In Thousands)	2016 Amount	% Total	2015 Amount	% Total	2014 Amount	% Total	2013 Amount	% Total	2012 Amount	% To
Commercial, financial, and agricultural	$146,110	13.36 %	$164,072	15.70 %	$124,156	13.56 %	$105,029	12.83 %	$48,455	9.46

Real estate mortgage:										
Residential	564,740	51.64	526,183	50.34	457,760	50.00	399,781	48.86	252,142	49.2
Commercial	306,182	28.00	302,539	28.95	291,348	31.82	282,476	34.52	182,031	35.5
Construction	34,650	3.17	26,824	2.57	21,996	2.40	17,282	2.11	20,067	3.92
Installment loans to individuals	43,256	3.96	27,001	2.58	21,509	2.35	14,647	1.79	10,659	2.08
Net deferred loan fees and discounts	(1,257)	(0.11)	(1,412)	(0.14)	(1,190)	(0.13)	(871)	(0.11)	(1,122)	(0.22
Gross loans	$1,093,681	100.00 %	$1,045,207	100.00 %	$915,579	100.00 %	$818,344	100.00 %	$512,232	100.

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The amounts of domestic loans at December 31, 2016 are presented below by category and maturity:

(In Thousands)	Commercial, financial, and agricultural	Real Estate Residential	Commercial	Construction	Installment Loans to Individuals	Total
Loans with variable interest rates:						
1 year or less	$ 24,622	$13,036	$ 16,547	$ 1,694	$ 1,150	$57,049
1 through 5 years	7,620	3,401	6,709	—	56	17,786
5 through 10 years	30,223	21,532	47,724	1,086	—	100,565
After 10 years	36,697	495,569	221,738	25,637	2,590	782,231
Total floating interest rate loans	99,162	533,538	292,718	28,417	3,796	957,631
Loans with fixed interest rates:						
1 year or less	1,532	1,193	1,401	2,328	738	7,192
1 through 5 years	22,631	6,099	6,290	2,340	23,097	60,457
5 through 10 years	21,612	9,274	4,251	631	13,560	49,328
After 10 years	1,173	14,636	1,522	934	2,065	20,330
Total predetermined interest rate loans	46,948	31,202	13,464	6,233	39,460	137,307
Total	$ 146,110	$564,740	$ 306,182	$ 34,650	$ 43,256	1,094,938
Net deferred loan fees and discounts						(1,257)
						$1,093,681

· The loan maturity information is based upon original loan terms and is not adjusted for "rollovers." In the ordinary course of business, loans maturing within one year may be renewed, in whole or in part, at interest rates prevailing at the date of renewal.
· Scheduled repayments are reported in maturity categories in which the payment is due.

The Banks do not make loans that provide for negative amortization, nor do any loans contain conversion features. The Banks did not have any foreign loans outstanding at December 31, 2016.

The following table shows the amount of accrual and nonaccrual TDRs at December 31, 2016 and 2015:

	2016			2015			2014		
(In Thousands)	Accrual	Nonaccrual	Total	Accrual	Nonaccrual	Total	Accrual	Nonaccrual	Total
Commercial, financial, and agricultural	$109	$ 132	$241	$320	$ 149	$469	$551	$ 440	$991
Real estate mortgage:									
Residential	1,491	541	2,032	1,428	353	1,781	697	181	878
Commercial	4,723	2,184	6,907	5,085	2,312	7,397	3,267	6,160	9,427
Construction	—	—	—	—	—	—	514	—	514
Installment loans to individuals	—	—	—	—	—	—	—	—	—
	$6,323	$ 2,857	$9,180	$6,833	$ 2,814	$9,647	$5,029	$ 6,781	$11,810

ALLOWANCE FOR LOAN LOSSES

2016

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio, as of the consolidated balance sheet date. All loan losses are charged to the allowance and all recoveries are credited to it per the allowance method of providing for loan losses. The allowance

for loan losses is established through a provision for loan losses charged to operations. The provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies,

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ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Banks. Management remains committed to an aggressive program of problem loan identification and resolution.

The allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management's consideration of the nature of the portfolio segments, changes in mix and volume of the loan portfolio, and historical loan loss experience. In addition, management considers industry standards and trends with respect to nonperforming loans and its knowledge and experience with specific lending segments.

The allowance for loan losses increased from $12,044,000 at December 31, 2015 to $12,896,000 at December 31, 2016. At December 31, 2016, the allowance for loan losses was 1.18% of total loans compared to 1.15% of total loans at December 31, 2015. The increase in the allowance for loan losses to total loans was the result of the increased allowance for loan losses that was partially offset by the increase in loan growth. The growth in the loan portfolio was driven by home equity product growth which historically is a lower risk product than commercial loans and requires a lower allowance for loan losses. Net loan charge-offs of $344,000 or 0.03% of average loans for the year ended December 31, 2016 limited the impact of the provision for loan losses of $1,196,000. Management concluded that the allowance for loan losses is adequate to provide for probable losses inherent in its loan portfolio as of the balance sheet date as noted in the provision for loan losses discussion.

Based on management's loan-by-loan review, the past performance of the borrowers, and current economic conditions, including recent business closures and bankruptcy levels, management does not anticipate any current losses related to nonaccrual, nonperforming, or classified loans above those that have already been considered in its overall judgment of the adequacy of the allowance for loan losses.

2015

The allowance for loan losses increased from $10,579,000 at December 31, 2014 to $12,044,000 at December 31, 2015. At December 31, 2015, the allowance for loan losses was 1.15% of total loans compared to 1.16% of total loans at December 31, 2014. The decrease in the allowance for loan losses to total loans was the result of the increased allowance for loan losses that was more than offset by the increase in loan growth. The growth in the loan portfolio was driven by home equity product growth which historically is a lower risk product than commercial loans and requires a lower allowance for loan losses. Net loan charge-offs of $835,000 or 0.09% of average loans for the year ended December 31, 2015 limited the impact of the provision for loan losses of $2,300,000.

Allocation of The Allowance For Loan Losses

	December 31, 2016		December 31, 2015		December 31, 2014		December 31, 2013		December 31, 2012	
(In Thousands)	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total	Amount	% Total
Balance at end of period applicable to:										
Commercial, financial, and agricultural	$1,554	13.34 %	$1,532	15.68 %	$1,124	13.54 %	$474	12.82 %	$361	9.44 %
Real estate mortgage:										
Residential	5,383	51.58	5,116	50.27	3,755	49.93	3,917	48.80	1,954	49.11
Commercial	4,975	27.96	4,217	28.91	4,205	31.78	4,079	34.48	3,831	35.46

Construction	178	3.17	160	2.56	786	2.40	741	2.11	950	3.91
Installment loans to individuals	416	3.95	243	2.58	245	2.35	139	1.79	144	2.08
Unallocated	390	—	776	—	464	—	794	—	377	—
	$12,896	100.00%	$12,044	100.00%	$10,579	100.00%	$10,144	100.00%	$7,617	100.00%

NONPERFORMING LOANS

The increase in nonperforming loans during 2016 is primarily the result of a large commercial real estate loan that was placed on non-accrual status. The majority of the nonperforming loans are centered on several loans that are either in a secured position and have sureties with a strong underlying financial position and/or a specific allowance within the allowance for loan losses.

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The following table presents information concerning nonperforming loans. The accrual of interest will be discontinued when the principal or interest of a loan is in default for 90 days or more, or as soon as payment is questionable, unless the loan is well secured and in the process of collection. Consumer loans and residential real estate loans secured by 1 to 4 family dwellings are not ordinarily subject to those guidelines. The reversal of previously accrued but uncollected interest applicable to any loan placed in a nonaccrual status and the treatment of subsequent payments of either principal or interest is handled in accordance with GAAP. These principles do not require a write-off of previously accrued interest if principal and interest are ultimately protected by sound collateral values. A nonperforming loan may be restored to accruing status when:

1. Principal and interest is no longer due and unpaid;
2. It becomes well secured and in the process of collection; and
3. Prospects for future contractual payments are no longer in doubt.

	Total Nonperforming Loans		
(In Thousands)	90 Days Past Due	Non-accrual	Total
2016	$ 1,457	$ 10,756	$ 12,213
2015	979	8,467	9,446
2014	387	11,861	12,248
2013	604	9,074	9,678
2012	351	11,355	11,706

The level of non-accruing loans continues to fluctuate annually and is attributed to the various economic factors experienced both regionally and nationally. Overall, the portfolio is well secured with a majority of the balance making regular payments or scheduled to be satisfied in the near future. Presently, there are no significant amounts of loans where serious doubts exist as to the ability of the borrower to comply with the current loan payment terms which are not included in the nonperforming categories as indicated above.

Management’s judgment in determining the amount of the additions to the allowance charged to operating expense considers the following factors with no single factor being determinative:

1. Economic conditions and the impact on the loan portfolio.
2. Analysis of past loan charge-offs experienced by category and comparison to outstanding loans.
3. Effect of problem loans on overall portfolio quality.
4. Reports of examination of the loan portfolio by the Department and the FDIC.

DEPOSITS

2016 vs. 2015

Total average deposits increased $68,214,000 or 6.76% from 2015 to 2016. The growth is a result of an emphasis to increase and solidify deposit relationships by focusing on core deposits, not time deposits. The actions caused average core deposits, which exclude time deposits, to increase to 79.44% in 2016 from 78.16% for 2015.

2015 vs. 2014

Total average deposits increased $26,704,000 or 2.72% from 2014 to 2015. The growth is a result of an emphasis to increase and solidify deposit relationships by focusing on core deposits, not time deposits. The actions caused average core deposits, which exclude time deposits, to increase to 78.16% in 2015 from 77.25% for 2014. The level of deposits has been negatively impacted by the Commonwealth of Pennsylvania budget impasse which has resulted in a

decreased level of deposits held by the various governmental entities serviced by the Banks.

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The average amount and the average rate paid on deposits are summarized below for the years ended December 31, 2016, 2015, and 2014:

	2016		2015		2014	
(In Thousands)	Average Amount	Rate	Average Amount	Rate	Average Amount	Rate
Noninterest-bearing	$279,130	0.00%	$251,029	0.00%	$225,981	0.00%
Savings	151,397	0.04	143,055	0.04	140,575	0.06
Super Now	187,106	0.24	187,396	0.26	182,229	0.32
Money Market	238,175	0.27	207,252	0.27	210,066	0.27
Time	221,498	1.08	220,360	0.92	223,537	0.79
Total average deposits	$1,077,306	0.33%	$1,009,092	0.31%	$982,388	0.31%

SHAREHOLDERS' EQUITY

2016

Shareholders' equity increased $1,970,000 to $138,249,000 at December 31, 2016 compared to December 31, 2015. Since December 31, 2015, treasury stock purchases of $574,000 for 14,600 shares were completed as part of the stock repurchase plan. The change in accumulated other comprehensive loss from $3,799,000 at December 31, 2015 to $4,928,000 at December 31, 2016 is a result of an increase in unrealized losses on available for sale securities from an unrealized gain of $258,000 at December 31, 2015 to an unrealized loss of $639,000 at December 31, 2016. The amount of accumulated other comprehensive loss at December 31, 2016 was also impacted by the change in net excess of the projected benefit obligation over the fair value of the plan assets of the defined benefit pension plan resulting in a increase in the net loss of $232,000 to $4,289,000 at December 31, 2016. The current level of shareholders' equity equates to a book value per share of $29.20 at December 31, 2016 compared to $28.71 at December 31, 2015 and an equity to asset ratio of 10.25% at December 31, 2016 compared to 10.32% at December 31, 2015. Excluding goodwill and intangibles, book value per share was $25.21 at December 31, 2016 compared to $24.84 at December 31, 2015. Dividends declared for each of the three and twelve months ended December 31, 2016 and 2015 were $0.47 and $1.88 per share.

2015

Shareholders' equity increased $312,000 to $136,279,000 at December 31, 2015 compared to December 31, 2014. Since December 31, 2014, treasury stock purchases of $2,603,000 for 60,018 shares were completed as part of the stock repurchase plan. The change in accumulated other comprehensive loss from $1,667,000 at December 31, 2014 to $3,799,000 at December 31, 2015 is a result of a decrease in unrealized gains on available for sale securities from an unrealized gain of $2,930,000 at December 31, 2014 to an unrealized gain of $258,000 at December 31, 2015. The amount of accumulated other comprehensive loss at December 31, 2015 was also impacted by the change in net excess of the projected benefit obligation over the fair value of the plan assets of the defined benefit pension plan resulting in a decrease in the net loss of $540,000 to $4,057,000 at December 31, 2015. The current level of shareholders' equity equates to a book value per share of $28.71 at December 31, 2015 compared to $28.30 at December 31, 2014 and an equity to asset ratio of 10.32% at December 31, 2015 compared to 10.92% at December 31, 2014. Excluding goodwill and intangibles, book value per share was $24.84 at December 31, 2015 compared to $24.44 at December 31, 2014. Dividends declared for each of the three and twelve months ended December 31, 2015 and 2014 were $0.47 and $1.88 per share.

Bank regulators have risk based capital guidelines. Under these guidelines the Company and each Bank are required to maintain minimum ratios of core capital and total qualifying capital as a percentage of risk weighted assets and certain off-balance sheet items. At December 31, 2016, both the Company's and each Bank's required ratios were well above the minimum ratios as follows:

	Company	Jersey Shore State Bank	Luzerne Bank	Minimum Standards
Common equity tier 1 capital ratio	12.62 %	11.14 %	10.16 %	4.50 %
Tier 1 capital ratio	12.62 %	11.14 %	10.16 %	6.00 %
Total capital ratio	13.38 %	11.73 %	10.98 %	8.00 %
Tier 1 capital	9.43 %	8.89 %	8.54 %	4.00 %

For a more comprehensive discussion of these requirements, see "Regulation and Supervision" in Item 1 of the Annual Report on Form 10-K. Management believes that the Company will continue to exceed regulatory capital requirements.

RETURN ON EQUITY AND ASSETS

The ratio of net income to average total assets and average shareholders' equity, and other certain equity ratios are presented as follows:

	2016	2015	2014
Percentage of net income to:			
Average total assets	0.93 %	1.08 %	1.19 %
Average shareholders' equity	8.96 %	10.11 %	10.79 %
Percentage of dividends declared to net income	71.37 %	64.52 %	61.99 %
Percentage of average shareholders' equity to average total assets	10.38 %	10.68 %	11.05 %

LIQUIDITY, INTEREST RATE SENSITIVITY, AND MARKET RISK

The Asset/Liability Committee addresses the liquidity needs of the Company to ensure that sufficient funds are available to meet credit demands and deposit withdrawals as well as to the placement of available funds in the investment portfolio. In assessing liquidity requirements, equal consideration is given to the current position as well as the future outlook.

The following liquidity measures are monitored for compliance and were within the limits cited at December 31, 2016:

1. Net Loans to Total Assets, 85% maximum
2. Net Loans to Total Deposits, 100% maximum
3. Cumulative 90 day Maturity GAP %, +/- 20% maximum
4. Cumulative 1 Year Maturity GAP %, +/- 25% maximum

Fundamental objectives of the Company's asset/liability management process are to maintain adequate liquidity while minimizing interest rate risk. The maintenance of adequate liquidity provides the Company with the ability to meet its financial obligations to depositors, loan customers, and shareholders. Additionally, it provides funds for normal operating expenditures and business opportunities as they arise. The objective of interest rate sensitivity management is to increase net interest income by managing interest sensitive assets and liabilities in such a way that they can be repriced in response to changes in market interest rates.

The Company, like other financial institutions, must have sufficient funds available to meet its liquidity needs for deposit withdrawals, loan commitments, and expenses. In order to control cash flow, the Company estimates future flows of cash from deposits and loan payments. The primary sources of funds are deposits, principal and interest payments on loans and mortgage-backed securities, as well as FHLB borrowings. Funds generated are used principally to fund loans and purchase investment securities. Management believes the Company has adequate resources to meet its normal funding requirements.

Management monitors the Company's liquidity on both a short and long-term basis, thereby, providing management necessary information to react to current balance sheet trends. Cash flow needs are assessed and sources of funds are determined. Funding strategies consider both customer needs and economical cost. Both short and long term funding

needs are addressed by maturities and sales of available for sale investment securities, loan repayments and maturities, and liquidating money market investments such as federal funds sold. The use of these resources, in conjunction with access to credit, provides core ingredients to satisfy depositor, borrower, and creditor needs.

Management monitors and determines the desirable level of liquidity. Consideration is given to loan demand, investment opportunities, deposit pricing and growth potential, as well as the current cost of borrowing funds. The Company has a current borrowing capacity at the FHLB of $538,195,000 with $85,625,000 utilized, leaving $452,571,000 available. In addition to this credit arrangement, the Company has additional lines of credit with correspondent banks of $45,247,000. The Company's management believes that it has sufficient liquidity to satisfy estimated short-term and long-term funding needs.

Interest rate sensitivity, which is closely related to liquidity management, is a function of the repricing characteristics of the Company's portfolio of assets and liabilities. Asset/liability management strives to match maturities and rates between loan and

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investment security assets with the deposit liabilities and borrowings that fund them. Successful asset/liability management results in a balance sheet structure which can cope effectively with market rate fluctuations. The matching process is affected by segmenting both assets and liabilities into future time periods (usually 12 months, or less) based upon when repricing can be effected. Repriceable assets are subtracted from repriceable liabilities, for a specific time period to determine the "gap", or difference. Once known, the gap is managed based on predictions about future market interest rates. Intentional mismatching, or gapping, can enhance net interest income if market rates move as predicted. However, if market rates behave in a manner contrary to predictions, net interest income will suffer. Gaps, therefore, contain an element of risk and must be prudently managed. In addition to gap management, the Company has an asset liability management policy which incorporates a market value at risk calculation which is used to determine the effects of interest rate movements on shareholders' equity and a simulation analysis to monitor the effects of interest rate changes on the Company's balance sheet.

The Company currently maintains a gap position of being asset sensitive. The Company has strategically taken this position as it has decreased the duration of the earning asset portfolio by adding quality short and intermediate term loans such as home equity loans and the selling of long-term municipal bonds. Lengthening of the liability portfolio is being undertaken to build protection in a rising rate environment.

A market value at risk calculation is utilized to monitor the effects of interest rate changes on the Company's balance sheet and more specifically shareholders' equity. The Company does not manage the balance sheet structure in order to maintain compliance with this calculation. The calculation serves as a guideline with greater emphasis placed on interest rate sensitivity. Changes to calculation results from period to period are reviewed as changes in results could be a signal of future events.

INTEREST RATE SENSITIVITY

In this analysis the Company examines the result of various changes in market interest rates in 100 basis point increments and their effect on net interest income. It is assumed that the change is instantaneous and that all rates move in a parallel manner. Assumptions are also made concerning prepayment speeds on mortgage loans and mortgage securities.

The following is a rate shock forecast for the twelve month period ended December 31, 2017 assuming a static balance sheet as of December 31, 2016.

	Parallel Rate Shock in Basis Points						
(In Thousands)	(200)	(100)	Static	100	200	300	400
Net interest income	$38,002	$40,401	$42,761	$44,678	$46,473	$48,031	$49,456
Change from static	(4,759)	(2,360)	—	1,917	3,712	5,270	6,695
Percent change from static	-11.13%	-5.52%	—	4.48%	8.68%	12.32%	15.66%

The model utilized to create the report presented above makes various estimates at each level of interest rate change regarding cash flow from principal repayment on loans and mortgage-backed securities and/or call activity on investment securities. Actual results could differ significantly from these estimates which would result in significant differences in the calculated projected change. In addition, the limits stated above do not necessarily represent the level of change under which management would undertake specific measures to realign its portfolio in order to reduce the projected level of change. Generally, management believes the Company is well positioned to respond expeditiously when the market interest rate outlook changes.

INFLATION

The asset and liability structure of a financial institution is primarily monetary in nature; therefore, interest rates rather than inflation have a more significant impact on the Company's performance. Interest rates are not always affected in the same direction or magnitude as prices of other goods and services, but are reflective of fiscal policy initiatives or economic factors that are not measured by a price index.

CRITICAL ACCOUNTING POLICIES

The Company's accounting policies are integral to understanding the results reported. The accounting policies are described in detail in Note 1 of the "Notes to Consolidated Financial Statements." Our most complex accounting policies require management's judgment to ascertain the valuation of assets, liabilities, commitments, and contingencies. We have established detailed policies and control procedures that are intended to ensure valuation methods are well controlled and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an

appropriate manner. The following is a brief description of our current accounting policies involving significant management valuation judgments.

Other Than Temporary Impairment of Debt and Equity Securities

Debt and equity securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reason underlying the decline, to determine whether the loss in value is other than temporary. The term “other than temporary” is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized. For a full discussion of the Company’s methodology of assessing impairment, refer to Note 4 of the “Notes to Consolidated Financial Statements.”

Allowance for Loan Losses

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The Company’s allowance for loan losses provides for probable losses based upon evaluations of known and inherent risks in the loan portfolio.

Management uses historical information to assess the adequacy of the allowance for loan losses as well as the prevailing business environment; as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the Company’s methodology of assessing the adequacy of the reserve for allowance for loan losses, refer to Note 1 of the “Notes to Consolidated Financial Statements.”

Goodwill and Other Intangible Assets

As discussed in Note 8 of the “Notes to Consolidated Financial Statements,” the Company must assess goodwill and other intangible assets each year for impairment. This assessment involves estimating cash flows for future periods. If the future cash flows were less than the recorded goodwill and other intangible assets balances, we would be required to take a charge against earnings to write down the assets to the lower value.

Deferred Tax Assets

Management uses an estimate of future earnings to support their position that the benefit of their deferred tax assets will be realized. If future income should prove non-existent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and the Company’s net income will be reduced. The Company’s deferred tax assets are described further in Note 12 of the “Notes to Consolidated Financial Statements.”

Pension Benefits

Pension costs and liabilities are dependent on assumptions used in calculating such amounts. These assumptions include discount rates, benefits earned, interest costs, expected return on plan assets, mortality rates, and other factors. In accordance with GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation of future periods. While

management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect the Company’s pension obligations and future expense. Our pension benefits are described further in Note 13 of the “Notes to Consolidated Financial Statements.”

CONTRACTUAL OBLIGATIONS

The Company has various financial obligations, including contractual obligations which may require future cash payments. The following table presents, as of December 31, 2016, significant fixed and determinable contractual obligations to third parties by payment date. Further discussion of the nature of each obligation is included in the “Notes to Consolidated Financial Statements.”

(In Thousands)	Payments Due In One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	$876,839	$ —	$ —	$ —	$876,839
Time deposits	93,847	107,293	15,805	1,430	218,375
Repurchase agreements	13,241	—	—	—	13,241
Short-term borrowings	—	—	—	—	—
Long-term borrowings	45,028	19,350	18,394	3,226	85,998
Operating leases	589	1,079	832	1,507	4,007

The Company’s operating lease obligations represent short and long-term lease and rental payments for branch facilities and equipment. The Bank leases certain facilities under operating leases which expire on various dates through 2027. Renewal options are available on the majority of these leases.

CAUTIONARY STATEMENT FOR PURPOSES OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Report contains certain “forward-looking statements” including statements concerning plans, objectives, future events or performance and assumptions and other statements which are other than statements of historical fact. The Company wishes to caution readers that the following important factors, among others in addition to the factors discussed in Item 1 - Business and in Item 1A - Risk Factors, may have affected and could in the future affect the Company’s actual results and could cause the Company’s actual results for subsequent periods to differ materially from those expressed in any forward-looking statement made by or on behalf of the Company herein: (i) the effect of changes in laws and regulations, including federal and state banking laws and regulations, with which the Company must comply, and the associated costs of compliance with such laws and regulations either currently or in the future as applicable; (ii) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies as well as by the Financial Accounting Standards Board, or of changes in the Company’s organization, compensation and benefit plans; (iii) the effect on the Company’s competitive position within its market area of the increasing consolidation within the banking and financial services industries, including the increased competition from larger regional and out-of-state banking organizations as well as non-bank providers of various financial services; (iv) the effect of changes in interest rates;and (v) the effect of changes in the business cycle and downturns in the local, regional or national economies.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk for the Company is comprised primarily from interest rate risk exposure and liquidity risk. Interest rate risk and liquidity risk management is performed at the Banks' level as well as the Company level. The Company’s interest rate sensitivity is monitored by management through selected interest rate risk measures produced internally. Additional information and details are provided in the Interest Sensitivity section of Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Generally, management believes the Company is well positioned to respond expeditiously when the market interest rate outlook changes.

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ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Penns Woods Bancorp, Inc.

We have audited the accompanying consolidated balance sheet of Penns Woods Bancorp, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. These consolidated financial statements are the responsibility of Penns Woods Bancorp, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Penns Woods Bancorp, Inc. and subsidiaries as of December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Penns Woods Bancorp, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 10, 2017, expressed an unqualified opinion on the effectiveness of Penns Woods Bancorp, Inc.'s internal control over financial reporting.

Cranberry Township, Pennsylvania
March 10, 2017

PENNS WOODS BANCORP, INC.
CONSOLIDATED BALANCE SHEET

	December 31,	
(In Thousands, Except Share Data)	2016	2015
ASSETS:		
Noninterest-bearing balances	$26,766	$22,044
Interest-bearing deposits in other financial institutions	16,905	752
Total cash and cash equivalents	43,671	22,796
Investment securities available for sale, at fair value	133,492	176,157
Investment securities, trading	58	73
Loans held for sale	1,953	757
Loans	1,093,681	1,045,207
Allowance for loan losses	(12,896)	(12,044)
Loans, net	1,080,785	1,033,163
Premises and equipment, net	24,275	21,830
Accrued interest receivable	3,672	3,686
Bank-owned life insurance	27,332	26,667
Investment in limited partnerships	586	899
Goodwill	17,104	17,104
Intangibles	1,799	1,240
Deferred tax asset	8,397	8,990
Other assets	5,466	6,695
TOTAL ASSETS	$1,348,590	$1,320,057
LIABILITIES:		
Interest-bearing deposits	$791,937	$751,797
Noninterest-bearing deposits	303,277	280,083
Total deposits	1,095,214	1,031,880
Short-term borrowings	13,241	46,638
Long-term borrowings	85,998	91,025
Accrued interest payable	455	426
Other liabilities	15,433	13,809
TOTAL LIABILITIES	1,210,341	1,183,778
SHAREHOLDERS' EQUITY:		
Preferred stock, no par value, 3,000,000 shares authorized; no shares issued	—	—
Common stock, par value $8.33, 15,000,000 shares authorized; 5,007,109 and 5,004,984 shares issued	41,726	41,708
Additional paid-in capital	50,075	49,992
Retained earnings	61,610	58,038
Accumulated other comprehensive loss:		
Net unrealized (loss) gain on available for sale securities	(639)	258
Defined benefit plan	(4,289)	(4,057)
Treasury stock at cost, 272,452 and 257,852 shares	(10,234)	(9,660)
TOTAL SHAREHOLDERS' EQUITY	138,249	136,279
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,348,590	$1,320,057

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF INCOME

(In Thousands, Except Per Share Data)	Year Ended December 31, 2016	2015	2014
INTEREST AND DIVIDEND INCOME:			
Loans, including fees	$42,056	$39,134	$36,495
Investment securities:			
Taxable	2,424	3,426	5,111
Tax-exempt	1,498	2,795	3,453
Dividend and other interest income	835	769	547
TOTAL INTEREST AND DIVIDEND INCOME	46,813	46,124	45,606
INTEREST EXPENSE:			
Deposits	3,547	3,129	2,995
Short-term borrowings	46	116	54
Long-term borrowings	1,974	1,974	1,913
TOTAL INTEREST EXPENSE	5,567	5,219	4,962
NET INTEREST INCOME	41,246	40,905	40,644
PROVISION FOR LOAN LOSSES	1,196	2,300	2,850
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	40,050	38,605	37,794
NON-INTEREST INCOME:			
Service charges	2,249	2,383	2,419
Securities gains, available for sale	1,611	2,592	3,515
Securities gains (losses), trading	58	(22)	—
Bank-owned life insurance	684	720	923
Gain on sale of loans	2,102	1,743	1,803
Insurance commissions	795	781	1,146
Brokerage commissions	1,098	1,064	1,077
Other	3,516	3,504	3,625
TOTAL NON-INTEREST INCOME	12,113	12,765	14,508
NON-INTEREST EXPENSE:			
Salaries and employee benefits	17,813	17,023	17,273
Occupancy	2,223	2,248	2,301
Furniture and equipment	2,793	2,622	2,536
Pennsylvania shares tax	873	954	907
Amortization of investment in limited partnerships	312	661	661
Federal Deposit Insurance Corporation deposit insurance	767	867	746
Marketing	740	612	532
Intangible amortization	366	311	345
Other	9,204	8,438	8,589
TOTAL NON-INTEREST EXPENSE	35,091	33,736	33,890
INCOME BEFORE INCOME TAX PROVISION	17,072	17,634	18,412
INCOME TAX PROVISION	4,597	3,736	3,804

NET INCOME	$12,475	$13,898	$14,608
EARNINGS PER SHARE - BASIC AND DILUTED	$2.64	$2.91	$3.03
WEIGHTED AVERAGE SHARES OUTSTANDING - BASIC AND DILUTED	4,735,457	4,772,239	4,816,149
DIVIDENDS PER SHARE	$1.88	$1.88	$1.88

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Year Ended December 31,		
(In Thousands)	2016	2015	2014
Net Income	$12,475	$13,898	$14,608
Other comprehensive (loss) income:			
Change in unrealized gain (loss) on available for sale securities	252	(1,457)	11,242
Tax effect	(85)	495	(3,822)
Net realized gain included in net income	(1,611)	(2,592)	(3,515)
Tax effect	547	882	1,195
(Accretion) amortization of unrecognized pension and post-retirement items	(352)	817	(2,837)
Tax effect	120	(277)	964
Total other comprehensive (loss) income	(1,129)	(2,132)	3,227
Comprehensive income	$11,346	$11,766	$17,835

See accompanying notes to the consolidated financial statements.

PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(In Thousands, Except Per Share Data)	COMMON STOCK SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME	TREASURY STOCK	TOTAL SHAREHOLDERS' EQUITY
Balance, December 31, 2013	4,999,929	$41,665	$49,800	$47,554	$(4,894)	$(6,310)	$127,815
Net income				14,608			14,608
Other comprehensive income					3,227		3,227
Dividends declared, ($1.88 per share)				(9,055)			(9,055)
Common shares issued for employee stock purchase plan	2,720	23	96				119
Purchase of treasury stock (17,238 shares)						(747)	(747)
Balance, December 31, 2014	5,002,649	41,688	49,896	53,107	(1,667)	(7,057)	135,967
Net income				13,898			13,898
Other comprehensive loss					(2,132)		(2,132)
Dividends declared, ($1.88 per share)				(8,967)			(8,967)
Common shares issued for employee stock purchase plan	2,335	20	96				116
Purchase of treasury stock (60,018 shares)						(2,603)	(2,603)
Balance, December 31, 2015	5,004,984	41,708	49,992	58,038	(3,799)	(9,660)	136,279
Net income				12,475			12,475
Other comprehensive loss					(1,129)		(1,129)
Dividends declared, ($1.88 per share)				(8,903)			(8,903)
	2,125	18	83				101

Common shares issued for employee stock purchase plan							
Purchase of treasury stock (14,600 shares)						(574)	(574)
Balance, December 31, 2016	5,007,109	$41,726	$50,075	$61,610	$(4,928)	$(10,234)	$138,249

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
(In Thousands)	2016	2015	2014
OPERATING ACTIVITIES:			
Net Income	$12,475	$13,898	$14,608
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	3,146	3,366	3,078
Amortization of intangible assets	366	311	345
Provision for loan losses	1,196	2,300	2,850
Accretion and amortization of investment security discounts and premiums	870	873	672
Securities gains, net	(1,611)	(2,592)	(3,515)
Originations of loans held for sale	(68,362)	(56,058)	(51,119)
Proceeds of loans held for sale	69,268	57,594	53,998
Gain on sale of loans	(2,102)	(1,743)	(1,803)
Net securities (gains) losses, trading	(58)	22	—
Proceeds from sales of trading securities	3,826	709	—
Purchases of trading securities	(3,753)	(804)	—
Earnings on bank-owned life insurance	(684)	(720)	(923)
Decrease in deferred tax asset	1,543	209	124
Other, net	(7)	(1,630)	423
Net cash provided by operating activities	16,113	15,735	18,738
INVESTING ACTIVITIES:			
Investment securities available for sale:			
Proceeds from sales	44,829	65,672	102,145
Proceeds from calls and maturities	25,558	22,859	13,354
Purchases	(28,322)	(32,776)	(47,902)
Net increase in loans	(49,590)	(130,803)	(101,816)
Acquisition of bank premises and equipment	(4,061)	(2,285)	(2,795)
Proceeds from the sale of foreclosed assets	859	1,868	1,059
Purchase of bank-owned life insurance	(27)	(30)	(30)
Proceeds from bank-owned life insurance death benefit	—	—	367
Proceeds from redemption of regulatory stock	3,160	10,790	3,955
Purchases of regulatory stock	(3,178)	(12,818)	(4,583)
Net cash used for investing activities	(10,772)	(77,523)	(36,246)
FINANCING ACTIVITIES:			
Net increase (decrease) in interest-bearing deposits	40,140	13,756	(17,584)
Net increase in noninterest-bearing deposits	23,194	36,705	26,001
Proceeds from long-term borrowings	—	30,625	—
Repayment of long-term borrowings	(5,027)	(10,776)	(26)
Net (decrease) increase in short-term borrowings	(33,397)	5,820	14,102
Dividends paid	(8,903)	(8,967)	(9,055)
Issuance of common stock	101	116	119
Purchase of treasury stock	(574)	(2,603)	(747)
Net cash provided by financing activities	15,534	64,676	12,810
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	20,875	2,888	(4,698)
CASH AND CASH EQUIVALENTS, BEGINNING	22,796	19,908	24,606
CASH AND CASH EQUIVALENTS, ENDING	$43,671	$22,796	$19,908

See accompanying notes to the consolidated financial statements.

	Year Ended December 31,		
(In Thousands)	2016	2015	2014
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Interest paid	$ 5,538	$ 5,174	$ 4,986
Income taxes paid	4,025	2,933	3,750
Transfer of loans to foreclosed real estate	772	340	2,166

See accompanying notes to the consolidated financial statements.

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PENNS WOODS BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Penns Woods Bancorp, Inc. and its wholly owned subsidiaries, Jersey Shore State Bank ("JSSB"), Luzerne Bank ("Luzerne" collectively with JSSB "Banks"), Woods Real Estate Development Co., Inc., Woods Investment Company, Inc., and The M Group Inc. D/B/A The Comprehensive Financial Group ("The M Group"), a wholly owned subsidiary of JSSB, (collectively, the "Company"). All significant intercompany balances and transactions have been eliminated.

Nature of Business

The Banks engage in a full-service commercial banking business, making available to the community a wide range of financial services including, but not limited to, installment loans, credit cards, mortgage and home equity loans, lines of credit, construction financing, farm loans, community development loans, loans to non-profit entities and local government, and various types of demand and time deposits including, but not limited to, checking accounts, savings accounts, money market deposit accounts, certificates of deposit, and IRAs. Deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") to the extent provided by law.

The financial services are provided by the Banks to individuals, partnerships, non-profit organizations, and corporations through their twenty-three offices located in Clinton, Lycoming, Centre, Montour, Union, and Luzerne Counties, Pennsylvania.

Woods Real Estate Development Co., Inc. engages in real estate transactions on behalf of Penns Woods Bancorp, Inc. and the Banks.

Woods Investment Company, Inc., a Delaware holding company, is engaged in investing activities.

The M Group engages in securities brokerage and financial planning services, which include the sale of life insurance products, annuities, and estate planning services.

Operations are managed and financial performance is evaluated on a corporate-wide basis. Accordingly, all financial service operations are considered by management to be aggregated in one reportable operating segment.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, valuation of net deferred tax assets, impairment of goodwill, other than temporary impairment of debt and equity securities, fair value of financial instruments, and the valuation of real estate acquired through, or in lieu of, foreclosure on settlement of debt.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and in banks and federal funds sold. Interest-earning deposits mature within 90 days and are carried at cost. Net cash flows are reported for loan, deposit, and short-term borrowing transactions.

Restrictions on Cash and Cash Equivalents

Based on deposit levels, the Banks must maintain cash and other reserves with the Federal Reserve Bank of Philadelphia (FRB).

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Investment Securities

Investment securities are classified at the time of purchase, based on management's intention and ability, as securities held to maturity, securities available for sale, or securities held for trading. Debt securities acquired with the intent and ability to hold to maturity are stated at cost, adjusted for amortization of premium and accretion of discount, which are computed using the interest method and recognized as adjustments of interest income. Certain other debt securities have been classified as available for sale to serve principally as a source of liquidity. Unrealized holding gains and losses for available for sale securities are reported as a separate component of shareholders' equity, net of tax, until realized. Unrealized holding gains and losses for equity securities held for trading are recognized as a separate component within the income statement. Realized security gains and losses are computed using the specific identification method for debt securities and the average cost method for marketable equity securities. Interest and dividends on investment securities are recognized as income when earned.

Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors, including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security's ability to recover any decline in its fair value, whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in fair value, and a review of the Company's capital adequacy, interest rate risk position, and liquidity. The assessment of a security's ability to recover any decline in fair value, the ability of the issuer to meet contractual obligations, and management's intent and ability requires considerable judgment. A decline in value that is considered to be other-than-temporary is recorded as a loss within non-interest income in the Consolidated Statement of Income.

Investment securities fair values are based on observed market prices. Certain investment securities do not have observed bid prices and their fair value is based on instruments with similar risk elements. Since regulatory stock is redeemable at par, the Company carries it at cost.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff generally are stated at the principal amount outstanding, net of deferred fees and discounts, unamortized loan fees and costs, and the allowance for loan losses. Interest on loans is recognized as income when earned on the accrual method. The Company's general policy has been to stop accruing interest on loans when it is determined a reasonable doubt exists as to the collectability of additional interest. Income is subsequently recognized only to the extent that cash payments are received provided the loan is not delinquent in payment and, in management's judgment, the borrower has the ability and intent to make future principal payments. Otherwise, payments are applied to the unpaid principal balance of the loan. Loans are restored to accrual status if certain conditions are met, including but not limited to, the repayment of all unpaid interest and scheduled principal due, ongoing performance consistent with the contractual agreement, and the future expectation of continued, timely payments.

Loan origination and commitment fees as well as certain direct loan origination costs are being deferred and amortized as an adjustment to the related loan's yield over the contractual lives of the related loans.

Allowance for Loan Losses

The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio, as of the Consolidated Balance Sheet date. The allowance method is used in providing for loan losses. Accordingly, all loan losses are charged to the allowance and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses charged to operations. The

provision for loan losses is based upon management's quarterly review of the loan portfolio. The purpose of the review is to assess loan quality, identify impaired loans, analyze delinquencies, ascertain loan growth, evaluate potential charge-offs and recoveries, and assess general economic conditions in the markets served. An external independent loan review is also performed annually for the Bank. Management remains committed to an aggressive program of problem loan identification and resolution.

The allowance is calculated by applying loss factors to outstanding loans by type, excluding loans for which a specific allowance has been determined. Loss factors are based on management's consideration of the nature of the portfolio segments, changes in mix and volume of the loan portfolio, historical loan loss experience, and general economic conditions. In addition, management considers industry standards and trends with respect to nonperforming loans and its knowledge and experience with specific lending segments.

Although management believes that it uses the best information available to make such determinations and that the allowance for loan losses is adequate at December 31, 2016, future adjustments could be necessary if circumstances or economic conditions

differ substantially from the assumptions used in making the initial determinations. A downturn in the local economy, rising unemployment, or negative performance trends in financial information from borrowers could be indicators of subsequent increased levels of nonperforming assets and possible charge-offs, which would normally require increased loan loss provisions. An integral part of the periodic regulatory examination process is the review of the adequacy of the Banks' loan loss allowance. The regulatory agencies could require the Banks, based on their evaluation of information available at the time of their examination, to provide additional loan loss provisions to further supplement the allowance.

Impaired loans are commercial and commercial real estate loans for which it is probable the Banks will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Banks individually evaluate such loans for impairment and do not aggregate loans by major risk classifications. The definition of “impaired loans” is not the same as the definition of “nonaccrual loans,” although the two categories overlap. The Banks may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired if the loan is not a commercial or commercial real estate loan. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for these types of loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower’s prior payment record, and the amount of shortfall in relation to the principal and interest owed.

Loan Charge-off Policies

Loans are generally fully or partially charged down to the fair value of collateral securing the asset when:
- management judges the asset to be uncollectible;
- repayment is deemed to be protracted beyond reasonable time frames;
- the asset has been classified as a loss by either the internal loan review process or external examiners;
- the borrower has filed bankruptcy and the loss becomes evident due to a lack of assets; or
- the loan is 180 days past due unless both well secured and in the process of collection.

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower’s financial difficulties, management may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans.

In addition to the allowance for the pooled portfolios, management has developed a separate allowance for loans that are identified as impaired through a TDR. These loans are excluded from pooled loss forecasts and a separate reserve

is provided under the accounting guidance for loan impairment. Consumer loans whose terms have been modified in a TDR are also individually analyzed for estimated impairment.

Loans Held for Sale

In general, fixed rate residential mortgage loans originated by the Banks are held for sale and are carried at cost due to their short holding period, which can range from less than two weeks to a maximum of thirty days. Sold loans are not serviced by the Banks. Proceeds from the sale of loans in excess of the carrying value are accounted for as a gain. Total gains on the sale of loans are shown as a component of non-interest income within the Consolidated Statement of Income.

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Foreclosed Assets

Foreclosed assets are carried at the lower of cost or fair value less estimated selling costs. Prior to foreclosure, the value of the underlying loan is written down to the fair value of the real estate to be acquired by a charge to the allowance for loan losses, if necessary. Any subsequent write-downs are charged against operating expenses. Net operating expenses and gains and losses realized from disposition are included in non-interest expense and income, respectively, within the Consolidated Statement of Income.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using straight-line and accelerated methods over the estimated useful lives of the related assets, which range from five to ten years for furniture, fixtures, and equipment and fifteen to forty years for buildings and improvements. Costs incurred for routine maintenance and repairs are charged to operations as incurred. Costs of major additions and improvements are capitalized.

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain officers and directors. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized. Increases in the cash surrender value are recognized as a component of non-interest income within the Consolidated Statement of Income.

Goodwill

The Company performs an annual impairment analysis of goodwill for its purchased subsidiaries, Luzerne and The M Group. Based on the fair value of these reporting units, estimated using the expected present value of future cash flows, no impairment of goodwill was recognized in 2016, 2015, or 2014.

Intangible Assets

At December 31, 2016, the Company had intangible assets of $876,000 as a result of the acquisition of Luzerne National Bank Corporation, which is net of accumulated amortization of $1,138,000. These intangible assets will continue to be amortized using the sum-of-the-years digits method of amortization over ten years. The Company also had intangible assets of $923,000, which is net of accumulated amortization of $97,000, as a result of the purchase of two books of business related to investment product sales. The book of business intangible is being amortized using the straight-line method over a period of ten years.

Investments in Limited Partnerships

The Company is a limited partner in four partnerships at December 31, 2016 that provide low income elderly housing in the Company’s geographic market area. The carrying value of the Company’s investments in limited partnerships was $586,000 at December 31, 2016 and $899,000 at December 31, 2015. The investments are being amortized over the ten-year tax credit receipt period utilizing the straight-line method. The partnerships are amortized once the projects reach the level of occupancy needed to begin the ten year tax credit recognition period. Amortization of limited partnership investments amounted to $312,000 in 2016 and $661,000 in 2015 and 2014.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Company enters into off-balance sheet financial instruments. Those instruments consist of commitments to extend credit and standby letters of credit. When those instruments are funded or become payable, the Company reports the amounts in its financial statements.

Marketing Cost

Marketing costs are generally expensed as incurred.

Income Taxes

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the

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appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

Deferred tax assets and liabilities result from temporary differences in financial and income tax methods of accounting, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Company analyzed its deferred tax asset position and determined that there was not a need for a valuation allowance due to the Company’s ability to generate future ordinary and capital taxable income.

The Company when applicable recognizes interest and penalties on income taxes as a component of income tax provision.

Earnings Per Share

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated utilizing net income as reported in the numerator and weighted average shares outstanding in the denominator. The computation of diluted earnings per share differs in that the dilutive effects of any stock options are adjusted in the denominator.

Employee Benefits

Pension and employee benefits include contributions, determined actuarially, to a defined benefit retirement plan covering the eligible employees of JSSB. The plan is funded on a current basis to the extent that it is deductible under existing federal tax regulations. Pension and other employee benefits also include contributions to a defined contribution Section 401(k) plan covering eligible employees. Contributions matching those made by eligible employees are funded throughout the year. In addition, an elective contribution may be made annually at the discretion of the board of directors for the employees of JSSB with a contribution being made in 2015. No elective contributions were made for 2016.

The M Group Products and Income Recognition

The M Group product line is comprised primarily of annuities, life insurance, and mutual funds. The revenues generated from life insurance sales are commission only, as The M Group does not underwrite the policies. Life insurance sales include permanent and term policies with the majority of the policies written being permanent. Term life insurance policies are written for 10, 15, 20, and 30 year terms with the majority of the policies being written for 20 years. None of these products are offered as an integral part of lending activities.

Commissions from the sale of annuities are recognized at the time notice is received from the third party broker/dealer or an insurance company that the transaction has been accepted and approved, which is also the time when commission income is received.

Life insurance commissions are recognized at varying points based on the payment option chosen by the customer. Commissions from monthly and annual payment plans are recognized at the start of each annual period for the life

insurance, while quarterly and semi-annual premium payments are recognized quarterly and semi-annually when the earnings process is complete. For example, semi-annual payments on the first of January and July would result in commission income recognition on the first of January and July, while payments on the first of January, April, July, and October would result in commission income recognition on those dates. The potential for chargebacks only exists for those policies on a monthly payment plan since income is recognized at the beginning of the annual coverage period versus at the time of each monthly payment. No liability is maintained for chargebacks as these are removed from income at the time of the occurrence.

Accumulated Other Comprehensive Income (Loss)

The Company is required to present accumulated other comprehensive income (loss) in a full set of general-purpose financial statements for all periods presented. Accumulated other comprehensive income (loss) is comprised of unrealized holding gains (losses) on the available for sale securities portfolio and the unrecognized components of net periodic benefit costs of the defined benefit pension plan.

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Segment Reporting

The Company has determined that its only reportable segment is Community Banking.

Reclassification of Comparative Amounts

Certain items previously reported have been reclassified to conform to the current year's reporting format. Such reclassifications did not affect net income or shareholders' equity.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (a new revenue recognition standard). The Update's core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this Update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This Update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40). The amendments in this Update provide guidance in accounting principles generally accepted in the United States of America about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. This Update is not expected to have a significant impact on the Company's financial statements.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contract with Customers (Topic 606). The amendments in this Update defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. The Company is evaluating the effect of adopting this new accounting Update.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. The amendments in this Update require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this Update apply to all entities that present a classified statement of financial position. For public business entities, the amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments in this Update are effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period. The amendments in this Update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. This Update is not expected to have a significant impact on the Company's financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized

cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. All entities that are not public business entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which (a) the lease term is 12 months or less and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In March 2016, the FASB issued ASU 2016-05, Derivatives and Hedging (Topic 815). The amendments in this Update apply to all reporting entities for which there is a change in the counterparty to a derivative instrument that has been designated as a heading instrument under Topic 815. The standards in this Update clarify that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. For all other entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. An entity has an option to apply the amendments in this Update on either a prospective basis or a modified retrospective basis. Early adoption is permitted, including adoption in an interim period. This Update is not expected to have a significant impact on the Company's financial statements.

In March 2016, the FASB issued ASU 2016-06, Derivatives and Hedging (Topic 815). The amendments apply to all entities that are issuers of or investors in debt instruments (or hybrid financial instruments that are determined to have a debt host) with embedded call (put) options. The amendments in this Update clarify the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt host. An entity performing the assessment under the amendments in this Update is

required to assess the embedded call (put) options solely in accordance with the four-step decision sequence. For public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. For entities other than public business entities, the amendments in this Update are effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted, including

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adoption in an interim period. This Update is not expected to have a significant impact on the Company’s financial statements.

In March 2016, the FASB issued ASU 2016-07, Investments - Equity Method and Joint Ventures (Topic 323). The Update affects all entities that have an investment that becomes qualified for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence. The amendments in this Update eliminate the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. Therefore, upon qualifying for the equity method of accounting, no retroactive adjustment of the investment is required. The amendments in this Update require that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. The amendments in this Update are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Earlier application is permitted. This Update is not expected to have a significant impact on the Company’s financial statements.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606). The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services (that are an output of the entity’s ordinary activities) in exchange for consideration. The amendments in this Update do not change the core principle of the guidance in Topic 606; they simply clarify the implementation guidance on principal versus agent considerations. The amendments in this Update are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements of Update 2014-09. ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company’s financial position or results of operations.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718). The amendments in this Update affect all entities that issue share-based payment awards to their employees. The standards in this Update provide simplification for several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as with equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities. In addition to those simplifications, the amendments eliminate the guidance in Topic 718 that was indefinitely deferred shortly after the issuance of FASB Statement No. 123 (revised 2004), Share-Based Payment. This should not result in a change in practice because the guidance that is being superseded was never effective. For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted for any entity in any interim or annual period. This Update is not expected to have a significant impact on the Company’s financial statements.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606). The amendments in this Update affect entities with transactions included within the scope of Topic 606, which includes entities that enter into contracts with customers to transfer goods or services in exchange for consideration. The amendments in this Update do not change the core principle for revenue recognition in Topic 606. Instead, the amendments provide (1) more detailed guidance in a few areas and (2) additional implementation guidance and examples based on feedback the FASB received from its stakeholders. The amendments are expected to reduce the degree of judgment necessary to comply with Topic 606, which the FASB expects will reduce the potential for diversity arising in practice and reduce

the cost and complexity of applying the guidance. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements in Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In May 2016, the FASB issued ASU 2016-11, Revenue Recognition (Topic 605) and Derivative and Hedging (Topic 815), which rescinds SEC paragraphs pursuant to two SEC Staff Announcements at the March 3, 2016, Emerging Issues Task Force meeting. This Update did not have a significant impact on the Company's financial statements

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606), which among other things clarifies the objective of the collectability criterion in Topic 606, as well as certain narrow aspects of Topic 606. The amendments in this Update affect the guidance in ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which is not yet effective. The effective date and transition requirements for the amendments in this Update are the same as the effective date and transition requirements for Topic 606 (and any other Topic amended by Update 2014-09). ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. This Update is not expected to have a significant impact on the Company's financial statements

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"), which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"), which addresses eight specific cash flow issues with the objective of reducing diversity in practice. Among these include recognizing cash payments for debt prepayment or debt extinguishment as cash outflows for financing activities; cash proceeds received from the settlement of insurance claims should be classified on the basis of the related insurance coverage; and cash proceeds received from the settlement of bank-owned life insurance policies should be classified as cash inflows from investing activities while the cash payments for premiums on bank-owned policies may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that

elects early adoption must adopt all of the amendments in the same period. The amendments in this Update should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The
Company is currently evaluating the impact the adoption of the standard will have on the Company’s statement of cash flows.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) (“ASU 2016-16”), which requires recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset (excluding inventory) when the transfer occurs. Consequently, the amendments in this Update eliminate the exception for an intra-entity transfer of an asset other than inventory. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods within those annual reporting periods. For all other entities, the amendments are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual periods beginning after December 15, 2019. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. That is, earlier adoption should be in the first interim period if an entity issues interim financial statements. The amendments in this Update should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. This Update is not expected to have a significant impact on the Company’s financial statements.

In October 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230) (“ASU 2016-18”), which requires that a statement of cash flows explains the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments in this Update should be applied using a retrospective transition method to each period presented. The Company is currently evaluating the impact the adoption of the standard will have on the Company’s statement of cash flows.

In December 2016, the FASB issued ASU 2016-19, Technical Corrections and Improvements, which represents changes to clarify, correct errors, or make minor improvements to the Accounting Standards Codification. The amendments make the Accounting Standards Codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications. Most of the amendments in this Update do not require transition guidance and are effective upon issuance of this Update. This Update is not expected to have a significant impact on the Company’s financial statements.

In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers “ASU 2016-20”. This Update, among others things, clarifies that guarantee fees within the scope of Topic 460, Guarantees, (other than product or service warranties) are not within the scope of Topic 606. The effective date and transition requirements for ASU 2016-20 are the same as the effective date and transition requirements for the new revenue recognition guidance. For public entities with a calendar year-end, the new guidance is effective in the quarter and year beginning January 1, 2018. For all other entities with a calendar year-end, the new guidance is effective in the year ending December 31, 2019, and interim periods in 2020. The Company is currently evaluating the impact the adoption of the standard will have on the Company’s financial position or results of operations.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805), Clarifying the Definition of a Business “ASU 2017-01”, which provides a more robust framework to use in determining when a set of assets and activities (collectively referred to as a “set”) is a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further

evaluated. Public business entities should apply the amendments in this Update to annual periods beginning after December 15, 2017, including interim periods within those periods. All other entities should apply the amendments to annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The amendments in this Update should be applied prospectively on or after the effective date. This Update is not expected to have a significant impact on the Company’s financial statements.

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NOTE 2 - ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in accumulated other comprehensive income (loss) by component shown net of tax as of December 31, 2016 and 2015 were as follows:

(In Thousands)	Twelve Months Ended December 31, 2016			Twelve Months Ended December 31, 2015			Twelve Months Ended December 31, 2014		
	Net Unrealized Gain(Loss) on Available for Sale Securities	Defined Benefit Plan	Total	Net Unrealized Gain (Loss) on Available for Sale Securities	Defined Benefit Plan	Total	Net Unrealized Gain (Loss) on Available for Sale Securities	Defined Benefit Plan	Total
Beginning balance	$258	$(4,057)	$(3,799)	$2,930	$(4,597)	$(1,667)	$(2,169)	$(2,725)	$(4,894)
Other comprehensive income (loss) before reclassifications	167	(333)	(166)	(962)	435	(527)	7,419	(2,010)	5,409
Amounts reclassified from accumulated other comprehensive (loss) income	(1,064)	101	(963)	(1,710)	105	(1,605)	(2,320)	138	(2,182)
Net current-period other comprehensive (loss) income	(897)	(232)	(1,129)	(2,672)	540	(2,132)	5,099	(1,872)	3,227
Ending balance	$(639)	$(4,289)	$(4,928)	$258	$(4,057)	$(3,799)	$2,930	$(4,597)	$(1,667)

The reclassifications out of accumulated other comprehensive income shown, net of tax and parenthesis indicating debits to net income, as of December 31, 2016 and 2015 were as follows:

(In Thousands)	Amount Reclassified from Accumulated Other Comprehensive Income			
Details about Accumulated Other Comprehensive Income Components	Twelve Months Ended December 31, 2016	December 31, 2015	December 31, 2014	Affected Line Item in the Consolidated Statement of Income
Net realized gain on available for sale securities	$ 1,611	$ 2,592	$ 3,515	Securities gains, net
Income tax effect	(547)	(882)	(1,195)	Income tax provision
	1,064	1,710	2,320	Net of tax
Net unrecognized pension costs	(153)	(159)	(209)	Salaries and employee benefits
Income tax effect	52	54	71	Income tax provision
	$ (101)	$ (105)	$ (138)	Net of tax

NOTE 3 - PER SHARE DATA

There are no convertible securities which would affect the denominator in calculating basic and dilutive earnings per share; therefore, net income as presented on the consolidated statement of income will be used as the numerator. The following table sets forth the composition of the weighted average common shares (denominator) used in the basic and dilutive per share computation.

	Year Ended December 31, 2016	2015	2014
Weighted average common shares issued	5,005,971	5,003,691	5,001,171

Average treasury stock shares	(270,514)	(231,452)	(185,022)
Weighted average common shares used to calculate basic and diluted earnings per share	4,735,457	4,772,239	4,816,149

There were 38,750 stock options issued during the third quarter of 2015 with 26,500 outstanding at December 31, 2016. The outstanding stock options did not impact diluted earnings per share as the strike price of the options was greater than the market price. There were no stock options outstanding during 2014.

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NOTE 4 - INVESTMENT SECURITIES

The amortized cost, gross gains and losses, and fair values of investment securities at December 31, 2016 and 2015 are as follows:

	2016			
(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale (AFS):				
U.S. Government and agency securities	$—	$ —	$ —	$—
Mortgage-backed securities	9,295	182	(164)	9,313
Asset-backed securities	109	—	—	109
State and political securities	60,777	666	(509)	60,934
Other debt securities	53,046	137	(2,065)	51,118
Total debt securities	123,227	985	(2,738)	121,474
Financial institution equity securities	9,566	969	—	10,535
Other equity securities	1,667	—	(184)	1,483
Total equity securities	11,233	969	(184)	12,018
Total investment securities AFS	$134,460	$ 1,954	$ (2,922)	$133,492

	2015			
(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale (AFS):				
U.S. Government and agency securities	$3,586	$ —	$ (37)	$3,549
Mortgage-backed securities	9,785	284	(60)	10,009
Asset-backed securities	1,960	—	(20)	1,940
State and political securities	84,992	1,797	(234)	86,555
Other debt securities	59,832	185	(2,245)	57,772
Total debt securities	160,155	2,266	(2,596)	159,825
Financial institution equity securities	10,397	1,100	(14)	11,483
Other equity securities	5,214	70	(435)	4,849
Total equity securities	15,611	1,170	(449)	16,332
Total investment securities AFS	$175,766	$ 3,436	$ (3,045)	$176,157

The amortized cost and fair values of trading investment securities at December 31, 2016 and 2015 are as follows.

	2016			
(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trading:				
Financial institution equity securities	$—	$ —	$ —	$ —
Other equity securities	56	2	—	58
Total trading securities	$56	$ 2	$ —	$ 58

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(In Thousands)	2015 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Trading:				
Financial institution equity securities	$78	$ —	$ (5)	$ 73
Other equity securities	—	—	—	—
Total trading securities	$78	$ —	$ (5)	$ 73

The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31, 2016 and 2015.

	2016					
	Less than Twelve Months		Twelve Months or Greater		Total	
(In Thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for Sale (AFS)						
U.S. Government and agency securities	$—	$ —	$ —	$ —	$—	$ —
Mortgage-backed securities	3,572	(106)	3,627	(58)	7,199	(164)
Asset-backed securities	—	—	—	—	—	—
State and political securities	26,113	(509)	—	—	26,113	(509)
Other debt securities	28,140	(1,179)	12,240	(886)	40,380	(2,065)
Total debt securities	57,825	(1,794)	15,867	(944)	73,692	(2,738)
Financial institution equity securities	—	—	—	—	—	—
Other equity securities	727	(140)	756	(44)	1,483	(184)
Total equity securities	727	(140)	756	(44)	1,483	(184)
Total Investment Securities AFS	$58,552	$ (1,934)	$ 16,623	$ (988)	$75,175	$ (2,922)

	2015					
	Less than Twelve Months		Twelve Months or Greater		Total	
(In Thousands)	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for Sale (AFS)						
U.S. Government and agency securities	$—	$ —	$ 3,549	$ (37)	$3,549	$ (37)
Mortgage-backed securities	6,081	(60)	—	—	6,081	(60)
Asset-backed securities	1,626	(16)	314	(4)	1,940	(20)
State and political securities	7,345	(47)	1,656	(187)	9,001	(234)
Other debt securities	24,381	(530)	22,547	(1,715)	46,928	(2,245)
Total debt securities	39,433	(653)	28,066	(1,943)	67,499	(2,596)
Financial institution equity securities	—	—	53	(14)	53	(14)
Other equity securities	2,363	(277)	1,001	(158)	3,364	(435)
Total equity securities	2,363	(277)	1,054	(172)	3,417	(449)
Total Investment Securities AFS	$41,796	$ (930)	$ 29,120	$ (2,115)	$70,916	$ (3,045)

At December 31, 2016 there were 73 individual securities in a continuous unrealized loss position for less than twelve months and 10 individual securities in a continuous unrealized loss position for greater than twelve months.

The Company reviews its position quarterly and has asserted that at December 31, 2016 and 2015, the declines outlined in the above table represent temporary declines and the Company does not intend to sell and does not believe they will be required to sell these securities before recovery of their cost basis, which may be at maturity. The Company has concluded that any impairment

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of its investment securities portfolio is not other than temporary but is the result of interest rate changes that are not expected to result in the non-collection of principal and interest during the period.

The amortized cost and fair value of debt securities at December 31, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities since borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(In Thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 577	$ 577
Due after one year to five years	41,114	40,646
Due after five years to ten years	67,181	65,631
Due after ten years	14,355	14,620
Total	$ 123,227	$ 121,474

Total gross proceeds from sales of securities available for sale were $44,829,000 , $65,672,000, and $102,145,000 for 2016, 2015, and 2014, respectively. The following table represents gross realized gains and losses on those transactions:

	Year Ended December 31,		
(In Thousands)	2016	2015	2014
Gross realized gains:			
U.S. Government and agency securities	$ 11	$ —	$ 59
Mortgage-backed securities	35	—	89
State and political securities	787	1,571	2,327
Other debt securities	283	825	622
Financial institution equity securities	572	183	710
Other equity securities	217	132	491
Total gross realized gains	$ 1,905	$ 2,711	$ 4,298
Gross realized losses:			
U.S. Government and agency securities	$ 5	$ —	$ 45
Asset-backed securities	13	—	—
State and political securities	1	22	412
Other debt securities	189	54	209
Financial institution equity securities	—	—	—
Other equity securities	86	43	117
Total gross realized losses	$ 294	$ 119	$ 783

There were no impairment charges included in gross realized losses for the years ended December 31, 2016, 2015, and 2014.

Investment securities with a carrying value of approximately $95,199,000 and $131,089,000 at December 31, 2016 and 2015, respectively, were pledged to secure certain deposits, repurchase agreements, and for other purposes as required by law.

There is no concentration of investments that exceed ten percent of shareholders’ equity for any individual issuer, excluding those guaranteed by the U.S. Government.

NOTE 5 - FEDERAL HOME LOAN BANK STOCK

The Banks are members of the Federal Home Loan Bank ("FHLB") of Pittsburgh and as such, is required to maintain a minimum investment in stock of the FHLB that varies with the level of advances outstanding with the FHLB. The stock is bought from and sold to the FHLB based upon its $100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated for impairment as necessary. The stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB

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as compared to the capital stock amount and the length of time this situation has persisted (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB.

Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. Management considered that the FHLB maintains regulatory capital ratios in excess of all regulatory capital requirements, liquidity appears adequate, new shares of FHLB stock continue to change hands at the $100 par value, and the payment of dividends.

NOTE 6 - LOAN CREDIT QUALITY AND RELATED ALLOWANCE FOR LOAN LOSSES

Management segments the Banks' loan portfolio to a level that enables risk and performance monitoring according to similar risk characteristics. Loans are segmented based on the underlying collateral characteristics. Categories include commercial, financial,
and agricultural, real estate, and installment loans to individuals. Real estate loans are further segmented into three categories: residential, commercial, and construction.

The following table presents the related aging categories of loans, by segment, as of December 31, 2016 and 2015:

	2016				
(In Thousands)	Current	Past Due 30 To 89 Days	Past Due 90 Days Or More & Still Accruing	Non-Accrual	Total
Commercial, financial, and agricultural	$145,179	$785	$ 14	$ 132	$146,110
Real estate mortgage:					
Residential	553,053	9,112	587	1,988	564,740
Commercial	296,537	786	268	8,591	306,182
Construction	33,879	771	—	—	34,650
Installment loans to individuals	43,008	202	1	45	43,256
	1,071,656	$11,656	$ 870	$ 10,756	1,094,938
Net deferred loan fees and discounts	(1,257)				(1,257)
Allowance for loan losses	(12,896)				(12,896)
Loans, net	$1,057,503				$1,080,785

	2015				
(In Thousands)	Current	Past Due 30 To 89 Days	Past Due 90 Days Or More & Still Accruing	Non-Accrual	Total
Commercial, financial, and agricultural	$162,312	$ 164	$ —	$ 1,596	$164,072
Real estate mortgage:					
Residential	517,753	6,827	714	889	526,183
Commercial	295,784	720	265	5,770	302,539
Construction	26,545	67	—	212	26,824
Installment loans to individuals	26,572	429	—	—	27,001
	1,028,966	$ 8,207	$ 979	$ 8,467	1,046,619
Net deferred loan fees and discounts	(1,412)				(1,412)
Allowance for loan losses	(12,044)				(12,044)
Loans, net	$1,015,510				$1,033,163

Purchased loans acquired are recorded at fair value on their purchase date without a carryover of the related allowance for loan losses.

Upon acquisition, the Company evaluated whether each acquired loan (regardless of size) was within the scope of ASC 310-30. Purchased credit-impaired loans are loans that have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments. The fair value of

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purchased credit-impaired loans, on the acquisition date, was determined, primarily based on the fair value of loan collateral. The carrying value of purchased loans acquired with deteriorated credit quality was $125,000 at December 31, 2016.

On the acquisition date, the preliminary estimate of the unpaid principal balance for all loans evidencing credit impairment acquired in the Luzerne acquisition was $1,211,000 and the estimated fair value of the loans was $878,000. Total contractually required payments on these loans, including interest, at the acquisition date was $1,783,000. However, the Company's preliminary estimate of expected cash flows was $941,000. At such date, the Company established a credit risk related non-accretable discount (a discount representing amounts which are not expected to be collected from the customer nor liquidation of collateral) of $842,000 relating to these impaired loans, reflected in the recorded net fair value. Such amount is reflected as a non-accretable fair value adjustment to loans. The Company further estimated the timing and amount of expected cash flows in excess of the estimated fair value and established an accretable discount of $63,000 on the acquisition date relating to these impaired loans.

The following table presents the interest income if interest had been recorded based on the original loan agreement terms and rate of interest for non-accrual loans and interest income recognized on a cash basis for non-accrual loans as of December 31, 2016, 2015, and 2014:

	Year Ended December 31,					
	2016		2015		2014	
(In Thousands)	Interest Income That Would Have Been Recorded Based on Original Term and Rate	Interest Income Recorded on a Cash Basis	Interest Income That Would Have Been Recorded Based on Original Term and Rate	Interest Income Recorded on a Cash Basis	Interest Income That Would Have Been Recorded Based on Original Term and Rate	Interest Income Recorded on a Cash Basis
Commercial, financial, and agricultural	$6	$ —	$ 48	$ 53	$ 42	$ 33
Real estate mortgage:						
Residential	151	101	53	38	63	34
Commercial	496	105	281	54	600	264
Construction	3	2	16	—	63	2
	$656	$ 208	$ 398	$ 145	$ 768	$ 333

Impaired Loans

Impaired loans are loans for which it is probable the Banks will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Banks individually evaluate such loans for impairment and do not aggregate loans by major risk classifications. The definition of "impaired loans" is not the same as the definition of "non-accrual loans," although the two categories overlap. The Banks may choose to place a loan on non-accrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for these types of loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loan. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan is greater than $100,000 and if the loan is either on non-accrual status or has a risk rating of substandard or worse. Management may also elect to measure an individual loan for impairment if less than $100,000 on a case by case basis.

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively with the exception of loans identified as troubled debt restructurings. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower’s prior payment record, and the amount of shortfall in relation to the principal and interest owed. Interest income for impaired loans is recorded consistent to the Banks' policy on non-accrual loans.

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The following table presents the recorded investment, unpaid principal balance, and related allowance of impaired loans by segment as of December 31, 2016 and 2015:

	2016		
(In Thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial, financial, and agricultural	$ 109	$ 109	$ —
Real estate mortgage:			
Residential	1,584	1,584	—
Commercial	1,833	1,833	—
Construction	—	—	—
	3,526	3,526	—
With an allowance recorded:			
Commercial, financial, and agricultural	132	132	74
Real estate mortgage:			
Residential	1,893	1,893	437
Commercial	10,425	10,520	1,668
Construction	—	—	—
	12,450	12,545	2,179
Total:			
Commercial, financial, and agricultural	241	241	74
Real estate mortgage:			
Residential	3,477	3,477	437
Commercial	12,258	12,353	1,668
Construction	—	—	—
	$ 15,976	$ 16,071	$ 2,179

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(In Thousands)	2015 Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:			
Commercial, financial, and agricultural	$319	$ 319	$ —
Real estate mortgage:			
Residential	1,142	1,142	—
Commercial	1,735	1,785	—
Construction	212	212	—
	3,408	3,458	—
With an allowance recorded:			
Commercial, financial, and agricultural	150	150	75
Real estate mortgage:			
Residential	1,573	1,703	376
Commercial	10,752	10,752	1,653
Construction	—	—	—
	12,475	12,605	2,104
Total:			
Commercial, financial, and agricultural	469	469	75
Real estate mortgage:			
Residential	2,715	2,845	376
Commercial	12,487	12,537	1,653
Construction	212	212	—
	$15,883	$ 16,063	$ 2,104

The following table presents the average recorded investment in impaired loans and related interest income recognized for December 31, 2016, 2015, and 2014:

(In Thousands)	2016 Average Investment in Impaired Loans	Interest Income Recognized on an Accrual Basis on Impaired Loans	Interest Income Recognized on a Cash Basis on Impaired Loans
Commercial, financial, and agricultural	$400	$ 16	$ 1
Real estate mortgage:			
Residential	3,471	89	101
Commercial	12,887	187	110
Construction	138	—	—
	$16,896	$ 292	$ 212

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(In Thousands)	2015 Average Investment in Impaired Loans	Interest Income Recognized on an Accrual Basis on Impaired Loans	Interest Income Recognized on a Cash Basis on Impaired Loans
Commercial, financial, and agricultural	$1,031	$ 21	$ 10
Real estate mortgage:			
Residential	2,570	72	47
Commercial	17,529	342	80
Construction	865	1	53
	$21,995	$ 436	$ 190

(In Thousands)	2014 Average Investment in Impaired Loans	Interest Income Recognized on an Accrual Basis on Impaired Loans	Interest Income Recognized on a Cash Basis on Impaired Loans
Commercial, financial, and agricultural	$763	$ 26	$ 25
Real estate mortgage:			
Residential	1,245	46	20
Commercial	10,987	130	101
Construction	1,086	17	89
	$14,081	$ 219	$ 235

Additional funds totaling $23,000 are committed to be advanced in connection with impaired loans.

Modifications

The loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring (TDR), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

Loan modifications that are considered TDRs completed during the twelve months ended December 31, 2016 and 2015 were as follows:

	Year Ended December 31,					
	2016			2015		
(In Thousands, Except Number of Contracts)	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial, financial, and agricultural	—	$ —	$ —	4	$ 213	$ 213
Real estate mortgage:						
Residential	3	397	397	11	962	962
Commercial	1	400	400	6	1,013	1,013
Construction	—	—	—	1	398	398
Total	4	$ 797	$ 797	22	$ 2,586	$ 2,586

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The four new troubled debt restructurings that were granted for the year ended December 31, 2016 totaling $797,000 were granted term concessions.
Of the twenty-two new troubled debt restructurings granted for the year ended December 31, 2015, seven loans totaling $1,008,000 were granted payment concessions, four loans totaling $183,000 were granted term concessions, two loans totaling $287,000 were granted rate concessions, and nine loans totaling 1,108,000 were granted concessions due to other default.

Loan modifications considered troubled debt restructurings made during the twelve months previous to December 31, 2016 and December 31, 2015, that defaulted during the corresponding twelve month periods were as follows:

	Year Ended December 31, 2016		Year Ended December 31, 2015	
(In Thousands, Except Number of Contracts)	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
Commercial, financial, and agricultural	—	$ —	1	$ 106
Real estate mortgage:				
Residential	—	—	6	374
Commercial	—	—	1	242
Total	—	$ —	8	$ 722

Internal Risk Ratings

Management uses a ten point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized, and are aggregated as “Pass” rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are evaluated for Substandard classification. Loans in the Doubtful category exhibit the same weaknesses found in the Substandard loans, however, the weaknesses are more pronounced. Such loans are static and collection in full is improbable. However, these loans are not yet rated as loss because certain events may occur which would salvage the debt. Loans classified Loss are considered uncollectible and charge-off is imminent.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Banks have a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the pass category unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. An external annual loan review of large commercial relationships is performed, as well as a sample of smaller transactions. During 2016, the threshold for the annual loan review was commercial relationships $1,300,000 or greater for JSSB and $1,600,000 or greater for Luzerne. Confirmation of the appropriate risk category is included in the review. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard, Doubtful, or Loss on a quarterly basis.

The following table presents the credit quality categories identified above as of December 31, 2016 and 2015:

2016		
Commercial and	Real Estate Mortgages	Installment Loans

(In Thousands)	Agricultural	Residential	Commercial	Construction	to Individuals	Totals
Pass	$140,497	$561,440	$ 277,916	$ 34,493	$ 43,256	$1,057,602
Special Mention	2,943	740	11,143	—	—	14,826
Substandard	2,670	2,560	17,123	157	—	22,510
Total	$146,110	$564,740	$ 306,182	$ 34,650	$ 43,256	$1,094,938

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2015						
	Commercial and	Real Estate Mortgages			Installment Loans	
(In Thousands)	Agricultural	Residential	Commercial	Construction	to Individuals	Totals
Pass	$160,734	$522,853	$ 277,248	$ 26,612	$ 27,001	$1,014,448
Special Mention	1,669	823	8,625	—	—	11,117
Substandard	1,669	2,507	16,666	212	—	21,054
Total	$164,072	$526,183	$ 302,539	$ 26,824	$ 27,001	$1,046,619

2014						
	Commercial and	Real Estate Mortgages			Installment Loans	
(In Thousands)	Agricultural	Residential	Commercial	Construction	to Individuals	Totals
Pass	$118,210	$454,885	$ 256,444	$ 20,927	$ 21,509	$871,975
Special Mention	3,186	2,384	16,262	445	—	22,277
Substandard	2,760	491	18,642	624	—	22,517
Total	$124,156	$457,760	$ 291,348	$ 21,996	$ 21,509	$916,769

Allowance for Loan Losses

An allowance for loan losses (“ALL”) is maintained to absorb losses from the loan portfolio. The ALL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated future loss experience, and the amount of non-performing loans.

The Banks' methodology for determining the ALL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (previously discussed) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Banks' ALL.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. Allowances are segmented based on collateral characteristics previously disclosed, and consistent with credit quality monitoring. Loans that are collectively evaluated for impairment are grouped into two classes for evaluation. A general allowance is determined for “Pass” rated credits, while a separate pool allowance is provided for “Criticized” rated credits that are not individually evaluated for impairment.

For the general allowances historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors. A historical charge-off factor is calculated utilizing a twelve quarter moving average. However, management may adjust the moving average time frame by up to four quarters to adjust for variances in the economic cycle. Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; levels of and trends in delinquency rates and non-accrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of lending staff; and concentrations of credit from a loan type, industry, and/or geographic standpoint.

Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors. Management also monitors industry loss factors by loan segment for applicable adjustments to actual loss experience.

Management reviews the loan portfolio on a quarterly basis in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL.

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Activity in the allowance is presented for the twelve months ended December 31, 2016 and 2015:

2016							
	Commercial and Agricultural	Real Estate Mortgages			Installment Loans		
(In Thousands)		Residential	Commercial	Construction	to Individual	Unallocated	Totals
Beginning Balance	$1,532	$5,116	$ 4,217	$ 160	$ 243	$ 776	$12,044
Charge-offs	(167)	(39)	(93)	(2)	(229)	—	(530)
Recoveries	62	15	8	9	92	—	186
Provision	127	291	843	11	310	(386)	1,196
Ending Balance	$1,554	$5,383	$ 4,975	$ 178	$ 416	$ 390	$12,896

2015							
	Commercial and	Real Estate Mortgages			Installment Loans		
(In Thousands)	Agricultural	Residential	Commercial	Construction	to Individuals	Unallocated	Totals
Beginning Balance	$1,124	$3,755	$ 4,205	$ 786	$ 245	$ 464	$10,579
Charge-offs	(283)	(49)	(743)	(46)	(240)	—	(1,361)
Recoveries	176	81	182	23	64	—	526
Provision	515	1,329	573	(603)	174	312	2,300
Ending Balance	$1,532	$5,116	$ 4,217	$ 160	$ 243	$ 776	$12,044

2014							
	Commercial and	Real Estate Mortgages			Installment Loans		
(In Thousands)	Agricultural	Residential	Commercial	Construction	to Individuals	Unallocated	Totals
Beginning Balance	$474	$3,917	$ 4,079	$ 741	$ 139	$ 794	$10,144
Charge-offs	(289)	(65)	(2,038)	—	(142)	—	(2,534)
Recoveries	18	15	—	22	64	—	119
Provision	921	(112)	2,164	23	184	(330)	2,850
Ending Balance	$1,124	$3,755	$ 4,205	$ 786	$ 245	$ 464	$10,579

The Company grants commercial, industrial, residential, and installment loans to customers throughout north-central and north-eastern Pennsylvania. Although the Company has a diversified loan portfolio at December 31, 2016 and 2015, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within this region.

The Company has a concentration of loans at December 31, 2016 and 2015 as follows:

	2016	2015
Owners of residential rental properties	16.10%	16.21%
Owners of commercial rental properties	14.18%	14.22%

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The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2016 and 2015:

	2016						
(In Thousands)	Commercial and Agricultural	Real Estate Mortgages Residential	Commercial	Construction	Installment Loans to Individuals	Unallocated	Totals
Allowance for Loan Losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$74	$437	$ 1,668	$ —	$ —	$ —	$2,179
Collectively evaluated for impairment	1,480	4,946	3,307	178	416	390	10,717
Total ending allowance balance	$1,554	$5,383	$ 4,975	$ 178	$ 416	$ 390	$12,896
Loans:							
Individually evaluated for impairment	$241	$3,477	$ 12,258	$ —	$ —		$15,976
Loans acquired with deteriorated credit quality	—	—	—	—	—		—
Collectively evaluated for impairment	145,869	561,263	293,924	34,650	43,256		1,078,962
Total ending loans balance	$146,110	$564,740	$ 306,182	$ 34,650	$ 43,256		$1,094,938

	2015						
(In Thousands)	Commercial and Agricultural	Real Estate Mortgages Residential	Commercial	Construction	Installment Loans to Individuals	Unallocated	Totals
Allowance for Loan Losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$75	$376	$ 1,653	$ —	$ —	$ —	$2,104
Collectively evaluated for impairment	1,457	4,740	2,564	160	243	776	9,940
Total ending allowance balance	$1,532	5,116	$ 4,217	$ 160	$ 243	$ 776	$12,044
Loans:							
Individually evaluated for impairment	$469	$2,374	$ 12,487	$ 212	$ —		$15,542
Loans acquired with deteriorated credit quality	—	341	—	—	—		341
Collectively evaluated for impairment	163,603	523,468	290,052	26,612	27,001		1,030,736
Total ending loans balance	$164,072	526,183	$ 302,539	$ 26,824	$ 27,001		$1,046,619

NOTE 7 - PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows at December 31, 2016 and 2015:

(In Thousands)	2016	2015

Land	$6,400	$5,764
Premises	18,568	16,074
Furniture and equipment	8,825	8,231
Leasehold improvements	1,698	1,462
Total	35,491	31,531
Less accumulated depreciation and amortization	11,216	9,701
Net premises and equipment	$24,275	$21,830

Depreciation and amortization related to premises and equipment for the years ended 2016, 2015, and 2014 was $1,578,000, $1,564,000, and $1,494,000, respectively.

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NOTE 8 - GOODWILL AND OTHER INTANGIBLES

As of December 31, 2016 and 2015 goodwill had a gross carrying value of $17,380,000 and accumulated amortization of $276,000 resulting in a net carrying amount of $17,104,000.

The gross carrying amount of goodwill is tested for impairment in the third quarter of each fiscal year. Based on the fair value of the reporting unit, estimated using the expected present value of future cash flows, there was no evidence of impairment of the carrying amount at December 31, 2016 or 2015.

Identifiable intangibles are amortized to their estimated residual values over the expected useful lives. Such lives are also periodically reassessed to determine if any amortization period adjustments are required. Since the acquisition, no such adjustments were recorded. The identifiable intangible assets consist of a core deposit intangible and a trade name intangible which are being amortized on an accelerated basis, and also book of business intangible that is being amortized on a straightline basis over the useful life of such assets. The net carrying amount of the core deposit intangible, the trade name intangible, and the book of business intangible at December 31, 2016 was $818,000, $58,000, and $923,000 respectively, with $1,063,000, $75,000, and $97,000 accumulated amortization as of that date.

As of December 31, 2016, the estimated future amortization expense for the core deposit and trade name intangible was:

(In Thousands)	Core Deposit Intangible	Trade Name Intangible	Book of Business Intangible
2017	$ 220	$ 15	$ 102
2018	185	13	102
2019	151	11	102
2020	117	8	102
2021	83	6	102
2022	48	4	102
2023	14	1	102
2024	—	—	102
2025	—	—	102
2026	—	—	5
	$ 818	$ 58	$ 923

NOTE 9 - TIME DEPOSITS

Time deposits of $250,000 or more totaled approximately $32,167,000 on December 31, 2016 and $28,953,000 on December 31, 2015. Interest expense on time deposits of $100,000 or more was approximately $1,305,000, $1,112,000, and $875,000, for the years ended December 31, 2016, 2015, and 2014, respectively.

At December 31, 2016, the scheduled maturities on time deposits of $100,000 or more are as follows:

(In Thousands)	2016
Three months or less	$ 19,511
Three months to six months	11,307
Six months to twelve months	12,550

Over twelve months	63,500
Total	$106,868

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Total time deposit maturities are as follows at December 31, 2016:

(In Thousands)	2016
2017	$93,847
2018	63,939
2019	43,354
2020	11,957
2021	3,848
Thereafter	1,430
Total	$218,375

NOTE 10 - SHORT-TERM BORROWINGS

Short-term borrowings consist of securities sold under agreements to repurchase and primarily FHLB advances, which generally represent overnight or less than six month borrowings. In addition to the outstanding balances noted below, the Banks also have additional lines of credit totaling $45,247,000 available from correspondent banks other than the FHLB. The outstanding balances and related information for short-term borrowings are summarized as follows at December 31, 2016, 2015, and 2014:

(In Thousands)	2016		2015		2014	
Repurchase Agreements:						
Balance at year end	$13,241		$18,334		$13,987	
Maximum amount outstanding at any month end	17,827		18,614		18,801	
Average balance outstanding during the year	15,394		15,834		16,350	
Weighted-average interest rate:						
At year end	0.16	%	0.21	%	0.23	%
Paid during the year	0.18	%	0.21	%	0.22	%
Overnight:						
Balance at year end	$—		$28,304		$26,831	
Maximum amount outstanding at any month end	24,346		42,760		26,831	
Average balance outstanding during the year	3,124		23,075		5,992	
Weighted-average interest rate:						
At year end	—	%	0.43	%	0.27	%
Paid during the year	0.57	%	0.36	%	0.30	%

We utilize securities sold under agreements to repurchase to facilitate the needs of our customers and to facilitate secured short-term funding needs. Securities sold under agreements to repurchase are stated at the amount of cash received in connection with the transaction. We monitor collateral levels on a continuous basis. We may be required to provide additional collateral based on the fair value of the underlying securities. Securities pledged as collateral under repurchase agreements are maintained with our safekeeping agents.

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The remaining contractual maturity of repurchase agreements in the consolidated balance sheets as of December 31, 2016 and December 31, 2015 is presented in the following tables.

	2016	2015
	Remaining Contractual Maturity of the Agreements	
(In Thousands)	Overnight and Continuous	Overnight and Continuous
Repurchase Agreements:		
U.S. Government and agency securities	$—	$ 3,586
Mortgage-back securities	6,684	8,368
Asset-backed securities	109	1,960
State and political securities	5,241	8,015
Other debt securities	8,866	2,155
Total carrying value of collateral pledged	$20,900	$ 24,084
Total liability recognized for repurchase agreements	$13,241	$ 18,334

NOTE 11 - LONG-TERM BORROWINGS

The following represents outstanding long-term borrowings with the FHLB by contractual maturities at December 31, 2016 and 2015:

(In Thousands)		Weighted Average Interest Rate		Stated Interest Rate Range			
Description	Maturity	2016	2015	From	To	2016	2015
Variable	2017	4.22%	4.22%	4.15%	4.28%	20,000	20,000
Variable	2018	3.18%	3.18%	3.18%	3.18%	10,000	10,000
Total Variable		3.87%	3.87%			30,000	30,000
Fixed	2016	— %	0.75%	0.75%	0.75%	—	5,000
Fixed	2017	0.91%	0.91%	0.90%	0.97%	25,000	25,000
Fixed	2018	1.13%	1.13%	1.13%	1.13%	2,000	2,000
Fixed	2019	1.55%	1.55%	1.54%	1.55%	7,292	7,292
Fixed	2020	1.70%	1.70%	1.62%	1.79%	18,333	18,333
Fixed	2022	2.04%	2.04%	2.04%	2.04%	3,000	3,000
Total Fixed		1.32%	1.28%			55,625	60,625
Total		2.21%	2.14%			$85,625	$90,625

(In Thousands) Year Ending December 31,	Amount	Weighted Average Rate	
2017	$45,000	2.38	%
2018	12,000	2.84	%
2019	7,292	1.55	%
2020	18,333	1.70	%
Thereafter	3,000	2.04	%
	$85,625	2.21	%

The terms of the convertible borrowings allow the FHLB to convert the interest rate to an adjustable rate based on the three month London Interbank Offered Rate (“LIBOR”) at a predetermined anniversary date of the borrowing’s origination, ranging from three months to five years. If the FHLB converts the interest rate on one of the predetermined dates, the Bank has the ability to pay off the debt on the conversion date and quarterly thereafter without incurring the customary pre-payment penalty.

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The Banks maintain a credit arrangement which includes a revolving line of credit with the FHLB. Under this credit arrangement, at December 31, 2016 JSSB has a remaining borrowing capacity of $304,044,000 and Luzerne has a remaining capacity of $148,527,000, which are subject to annual renewal and typically incur no service charges. Under terms of a blanket agreement, collateral for the FHLB borrowings must be secured by certain qualifying assets of each Bank which consist principally of first mortgage loans and mortgage-backed securities.

In December 2012, JSSB entered in to a capital lease on a piece of land in Lewisburg, Pennsylvania. The carrying amount of the land as of December 31, 2016 and 2015 was $827,000. The present value of minimum lease payments at December 31, 2016 and 2015 was $373,000 and $400,000. The following is a schedule showing the future minimum lease payments under the capital lease by years and the present value of the minimum lease payments as of December 31, 2015. The interest rate related to the lease obligation is 2.75% and the maturity date is October 2023.

(In Thousands)	Lease Payment	Interest	Present Value of Minimum Lease Payment
2017	$ 38	$ 10	$ 28
2018	38	9	29
2019	38	9	29
2020	38	8	30
2021	38	7	31
Thereafter	237	11	226
	$ 427	$ 54	$ 373

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NOTE 12 - INCOME TAXES

The following temporary differences gave rise to the net deferred tax asset position at December 31, 2016 and 2015:

(In Thousands)	2016	2015
Deferred tax assets:		
Allowance for loan losses	$4,400	$3,976
Deferred compensation	1,840	1,696
Defined Pension	1,450	1,525
Deferred Loan fees and discounts	320	272
Investment securities allowance	517	517
Low income housing credit carryforward	—	1,181
Unrealized loss on available for sale securities	329	—
Other	1,393	1,696
Total	10,249	10,863
Deferred tax liabilities:		
Unrealized gain on available for sale securities	—	133
Investment security accretion	244	231
Depreciation	588	478
Amortization	1,020	1,031
Total	1,852	1,873
Deferred tax asset, net	$8,397	$8,990

No valuation allowance was established at December 31, 2016 and 2015, because of the Company's ability to carry back capital losses to recover taxes paid in previous years and certain tax strategies, together with the anticipated future taxable income as evidenced by the Company's earning potential. The Corporation is no longer subject to federal, state, and local examinations by tax authorities for years before 2013.

The provision or benefit for income taxes is comprised of the following for the year ended December 31, 2016, 2015, and 2014:

(In Thousands)	2016	2015	2014
Currently payable	$3,054	$3,527	$3,680
Deferred benefit	1,543	209	124
Total provision	$4,597	$3,736	$3,804

A reconciliation between the expected income tax or benefit and the effective income tax rate on income before income tax provision or benefit follows for the year ended December 31, 2016, 2015, and 2014:

	2016		2015		2014	
(In Thousands)	Amount	%	Amount	%	Amount	%
Provision at expected rate	$5,804	34.00 %	$5,996	34.00 %	$6,260	34.00 %
(Decrease) increase in tax resulting from:						
Tax-exempt income	(1,092)	(6.40)	(1,492)	(8.46)	(1,673)	(9.09)
Tax credits	(312)	(1.83)	(737)	(4.17)	(737)	(4.00)
Other, net	197	1.16	(31)	(0.18)	(46)	(0.25)
Effective income tax provision and rate	$4,597	26.93 %	$3,736	21.19 %	$3,804	20.66 %

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NOTE 13 - EMPLOYEE BENEFIT PLANS

Defined Benefit Pension Plan

The Company has a noncontributory defined benefit pension plan (the "Plan") for all employees meeting certain age and length of service requirements that were hired prior to January 1, 2004, at which time entrance into the Plan was frozen. The benefit accrual for the Plan was subsequently frozen at December 31, 2014. Benefits are based primarily on years of service and the average annual compensation during the highest five consecutive years within the final ten years of employment - up until December 31, 2014 when the benefit accrual was frozen.

The following table sets forth the obligation and funded status as of December 31, 2016 and 2015:

(In Thousands)	2016	2015
Change in benefit obligation:		
Benefit obligation at beginning of year	$18,947	$23,450
Interest cost	775	757
Actuarial loss (gain)	139	(144)
Benefits paid	(800)	(639)
Curtailment gain	—	(3,155)
Other, change in actuarial assumptions	228	(1,322)
Benefit obligation at end of year	$19,289	$18,947
Change in plan assets:		
Fair value of plan assets at beginning of year	$14,223	$13,906
Actual return on plan assets	910	25
Employer contribution	750	965
Benefits paid	(797)	(704)
Adjustment to fair value of plan assets	4	31
Fair value of plan assets at end of year	15,090	14,223
Funded status	$(4,199)	$(4,724)
Accounts recognized on balance sheet as:		
Total liabilities	$(4,199)	$(4,724)
Amounts not yet recognized as a component of net periodic pension cost:		
Amounts recognized in accumulated other comprehensive income (loss) consist of:		
Net loss	$6,498	$6,267

The accumulated benefit obligation for the Plan was $19,289,000 and $18,947,000 at December 31, 2016 and 2015, respectively.

Components of Net Periodic Cost and Other Amounts Recognized in Other Comprehensive Income (loss) as of December 31, 2016, 2015, and 2014 are as follows:

(In Thousands)	2016	2015	2014
Net periodic pension cost:			
Service cost	$55	$64	$560
Interest cost	775	757	859

Expected return on plan assets	(989)	(983)	(1,153)
Amortization of unrecognized net loss	153	159	209
Net periodic (cost) benefit	$(6)	$(3)	$475

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Assumptions

Weighted-average assumptions used to determine benefit obligations at December 31, 2016, 2015, and 2014:

	2016	2015	2014
Discount rate	3.98%	4.17%	3.83%
Rate of compensation increase	N/A	N/A	3.00%

Weighted-average assumptions used to determine net periodic cost for years ended December 31, 2016, 2015, and 2014:

	2016	2015	2014
Discount rate	4.17%	3.83%	4.75%
Expected long-term return on plan assets	7.00%	7.00%	8.00%
Rate of compensation increase	N/A	N/A	3.00%

The expected long-term rate of return was estimated using market benchmarks by which the plan assets would outperform the market value in the future, based on historical experience adjusted for changes in asset allocation and expectations for overall lower future returns on similar investments compared to past periods.

Plan Assets

The Plan's weighted-average asset allocations at December 31, 2016 and 2015 by asset category are as follows:

Asset Category	2016	2015
Cash	6.54 %	8.56 %
Fixed income securities	9.15 %	10.33 %
Equity	64.79 %	61.73 %
Inflation Hedges/Real Assets	5.55 %	5.03 %
Hedged Strategies	13.97 %	14.35 %
Total	100.00%	100.00%

The investment objective for the Plan is to maximize total return with tolerance for slightly above average risk, meaning the fund is able to tolerate short-term volatility to achieve above-average returns over the long term.

Asset allocation favors equities, with target allocation of approximately 62% equity securities, 15.0% fixed income securities, 10% inflation hedges/real assets, 10% hedged strategies, and 2.5% cash. Due to volatility in the market, the target allocation is not always desirable and asset allocations will fluctuate between the acceptable ranges. The equity portfolio's exposure is primarily in mid and large capitalization domestic equities with limited exposure to small capitalization and international stocks.

It is management's intent to give the investment managers flexibility, within the overall guidelines, with respect to investment decisions and their timing. However, certain investments require specific review and approval by management. Management is also informed of anticipated, significant modifications of any previously approved investment, or anticipated use of derivatives to execute investment strategies.

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The following table sets forth by level, within the fair value hierarchy detailed in Note 21 - Fair Value Measurements, the Plan's assets at fair value as of December 31, 2016 and 2015:

	2016			
(In Thousands)	Level I	Level II	Level III	Total
Assets:				
Cash and cash equivalents	$987	$ —	$ —	$987
Mutual funds - taxable fixed income	1,379	—	—	1,379
Mutual funds - domestic equity	8,944	—	—	8,944
Mutual funds - international equity	835	—	—	835
Inflation Hedges/Real Assets	838	—	—	838
Hedged Strategies	2,107	—	—	2,107
Total assets at fair value	$15,090	$ —	$ —	$15,090

	2015			
(In Thousands)	Level I	Level II	Level III	Total
Assets:				
Cash and cash equivalents	$1,218	$ —	$ —	$1,218
Mutual funds - taxable fixed income	1,467	—	—	1,467
Mutual funds - domestic equity	8,150	—	—	8,150
Mutual funds - international equity	631	—	—	631
Inflation Hedges/Real Assets	715	—	—	715
Hedged Strategies	2,042	—	—	2,042
Total assets at fair value	$14,223	$ —	$ —	$14,223

The following future benefit payments are expected to be paid:

(In Thousands)	
2017	$814
2018	824
2019	860
2020	893
2021	885
Thereafter	4,985
	$9,261

The company expects to contribute a minimum of $500,000 to its Pension Plan in 2017.

401(k) Savings Plan

The Company also offers a 401(k) savings plan in which eligible participating employees may elect to contribute up to a maximum percentage allowable not to exceed the limits of Code Sections 401(k), 404, and 415. The Company may make matching contributions equal to a discretionary percentage that is determined by the Board of Directors. Participants are at all times fully vested in their contributions and vest over a period of five years regarding the employer contribution. Contribution expense was approximately $215,000, $230,000, and $171,000 for the years ended December 31, 2016, 2015, and 2014, respectively.

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Deferred Compensation Plan

The Company has a deferred compensation plan whereby participating directors elect to forego directors' fees paid in cash. Under this plan, the Company will make payments for a ten-year period beginning at the later of age 65 or ceasing to be a director in most cases or at death, if earlier, at which time payments would be made to their designated beneficiaries.

To fund benefits under the deferred compensation plan, the Company has acquired bank-owned life insurance policies on the lives of the participating directors for which insurance benefits are payable to the Company. The Company incurred expenses related to the plan of $303,000, $252,000, and $235,000 for the years ended December 31, 2016, 2015, and 2014, respectively. Benefits paid under the plan were approximately $85,000, $103,000, and $88,000 in 2016, 2015, and 2014, respectively.

NOTE 14 - STOCK OPTIONS

In 2014, the Company adopted the 2014 Equity Incentive Plan designed to help the Company attract, retain, and motivate employees and non-employee directors. Incentive stock options, non-qualified stock options, and restricted stock may be granted as part of the plan.

On August 27, 2015, the Company issued 38,750 stock options to a group of employees. Each option granted has a strike price of $42.03 and is exercisable after five years following the date of the grant of such options. The options expire ten years following the date of the grant of such options.

A summary of stock option activity is presented below:

	2016		2015	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	34,750	$ 42.03	—	$ —
Granted	—	—	38,750	42.03
Exercised	—	—	—	—
Forfeited	(8,250)	42.03	(4,000)	42.03
Outstanding, end of year	26,500	$ 42.03	34,750	$ 42.03

The estimated fair value of options, including the effect of estimated forfeitures, is recognized as expense on a straightline basis over the options' vesting periods while ensuring that the cumulative amount of compensation cost recognized at least equals the value of the vested portion of the award at that date. The Company determines the fair value of options granted using the Black-Scholes option-pricing model. The risk-free interest rate is based on the United States Treasury bond with a similar term to the expected life of the options at the grant date. Expected volatility was estimated based on the adjusted historic volatility of the Company's shares. The expected life was estimated to equal the contractual life of the options. The dividend yield rate was based upon recent historical dividends paid on shares.

The following assumptions were used in determining the fair value of share options granted:

	2015
Risk-free interest rate	1.63 %

Expected volatility	31.58 %
Expected dividend yield	4.22 %
Expected life	7.51 years
Weighted average grant date fair value per option	$3.96

For the years ended December 31, 2016 and 2015, there was $14,000 and $19,000 in total share-based compensation expense, respectively. The compensation expense is recorded as part of the non-interest expenses in the Consolidated Statement of Income.

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As at December 31, 2016, total unrecognized compensation costs related to non-vested options was $77,000 which is expected to be recognized over a period of 3.66 years.

NOTE 15 - EMPLOYEE STOCK PURCHASE PLAN

The Company maintains a Penns Woods Bancorp, Inc. Employee Stock Purchase Plan (“Plan”). The Plan is intended to encourage employee participation in the ownership and economic progress of the Company. The Plan allows for up to 1,000,000 shares to be purchased by employees. The purchase price of the shares is 95% of market value with an employee eligible to purchase up to the lesser of 15% of base compensation or $12,000 in market value annually. There were 2,125 and 2,335 shares issued under the plan for the years ended December 31, 2016 and 2015, respectively.

NOTE 16 - RELATED PARTY TRANSACTIONS

Certain directors and executive officers of the Company and the Bank, including their immediate families and companies in which they are principal owners (more than ten percent), are indebted to the Company. Such indebtedness was incurred in the ordinary course of business on the same terms and at those rates prevailing at the time for comparable transactions with others.

A summary of loan activity with executive officers, directors, principal shareholders, and associates of such persons is listed below for the years ended December 31, 2016 and 2015:

(In Thousands)	Beginning Balance	New Loans	Repayments	Ending Balance
2015	$ 8,946	$8,693	$ (8,381)	$ 9,258
2016	9,258	5,875	(6,256)	8,877

Deposits from related parties held by the Banks amounted to $13,052,000 at December 31, 2016 and $13,330,000 at December 31, 2015.

NOTE 17 - COMMITMENTS AND CONTINGENT LIABILITIES

The following schedule shows future minimum rental payments under operating leases with noncancellable terms in excess of one year as of December 31, 2016:

(In Thousands)	
2017	$589
2018	599
2019	480
2020	463
2021	369
Thereafter	1,507
	$4,007

The Company’s operating lease obligations represent short and long-term lease and rental payments for facilities and equipment. Total rental expense for all operating leases for the years ended December 31, 2016, 2015, and 2014 were $573,000, $591,000 and $523,000.

The Company is subject to lawsuits and claims arising out of its business. There are no such legal proceedings or claims currently pending or threatened other than those encountered during the normal course of business.

NOTE 18 - OFF-BALANCE SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit, interest rate, or liquidity risk in excess of the amount recognized in the Consolidated Balance Sheet. The contract amounts of these instruments express the extent of involvement the Company has in particular classes of financial instruments.

The Company’s exposure to credit loss from nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Company may require collateral or other security to support financial instruments with off-balance sheet credit risk.

Financial instruments whose contract amounts represent credit risk are as follows at December 31, 2016 and 2015:

(In Thousands)	2016	2015
Commitments to extend credit	$263,487	$241,936
Standby letters of credit	6,515	4,786

Commitments to extend credit are legally binding agreements to lend to customers. Commitments generally have fixed expiration dates or other termination clauses and may require payment of fees. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future liquidity requirements. The Company evaluates each customer’s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, on an extension of credit is based on management’s credit assessment of the counterparty.

Standby letters of credit represent conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These instruments are issued primarily to support bid or performance related contracts. The coverage period for these instruments is typically a one year period with an annual renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized upon expiration of the coverage period. For secured letters of credit, the collateral is typically Bank deposit instruments or customer business assets.

NOTE 19 - CAPITAL REQUIREMENTS

Federal regulations require the Company and the Banks to maintain minimum amounts of capital. Specifically, each is required to maintain certain minimum dollar amounts and ratios of Common Equity Tier 1, Total, and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average total assets.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act (“FDICIA”) established five capital categories ranging from “well capitalized” to “critically undercapitalized.” Should any institution fail to meet the requirements to be considered “adequately capitalized,” it would become subject to a series of increasingly restrictive regulatory actions.

As of December 31, 2016 and 2015, the FDIC categorized the Banks as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well capitalized financial institution, common equity

tier I risk-based, tier I risked-based, total risk-based, and tier I leverage capital ratios must be at least 6.5%, 8%, 10%, and 5%, respectively.

The Company’s and the Banks' actual capital ratios are presented in the following tables, which shows that the Company and both Banks met all regulatory capital requirements.

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Consolidated Company

(In Thousands)	2016 Amount	Ratio	2015 Amount	Ratio
Common Equity Tier I Capital (to Risk-weighted Assets)				
Actual	$125,804	12.620%	$121,665	11.240%
For Capital Adequacy Purposes	44,849	4.500 %	48,722	4.500 %
Minimum To Maintain Capital Conservation Buffer	51,078	5.125 %	N/A	N/A
To Be Well Capitalized	64,782	6.500 %	70,377	6.500 %
Total Capital (to Risk-weighted Assets)				
Actual	$133,393	13.380%	$134,067	12.380%
For Capital Adequacy Purposes	79,732	8.000 %	86,617	8.000 %
Minimum To Maintain Capital Conservation Buffer	85,961	8.625 %	N/A	N/A
To Be Well Capitalized	99,665	10.000%	108,272	10.000%
Tier I Capital (to Risk-weighted Assets)				
Actual	$125,804	12.620%	$121,665	11.240%
For Capital Adequacy Purposes	59,799	6.000 %	64,963	6.000 %
Minimum To Maintain Capital Conservation Buffer	66,028	6.625 %	N/A	N/A
To Be Well Capitalized	79,732	8.000 %	86,617	8.000 %
Tier I Capital (to Average Assets)				
Actual	$125,804	9.432 %	$121,665	9.380 %
For Capital Adequacy Purposes	53,352	4.000 %	51,862	4.000 %
To Be Well Capitalized	66,691	5.000 %	64,828	5.000 %

Jersey Shore State Bank

(In Thousands)	2016 Amount	Ratio	2015 Amount	Ratio
Common Equity Tier I Capital (to Risk-weighted Assets)				
Actual	$86,397	11.136%	$82,682	10.700%
For Capital Adequacy Purposes	34,914	4.500 %	34,773	4.500 %
Minimum To Maintain Capital Conservation Buffer	39,763	5.125 %	N/A	N/A
To Be Well Capitalized	50,431	6.500 %	50,227	6.500 %
Total Capital (to Risk-weighted Assets)				
Actual	$90,992	11.728%	$92,036	11.910%
For Capital Adequacy Purposes	62,069	8.000 %	61,818	8.000 %
Minimum To Maintain Capital Conservation Buffer	66,918	8.625 %	N/A	N/A
To Be Well Capitalized	77,587	10.000%	77,272	10.000%
Tier I Capital (to Risk-weighted Assets)				
Actual	$86,397	11.136%	$82,682	10.700%
For Capital Adequacy Purposes	46,552	6.000 %	46,363	6.000 %
Minimum To Maintain Capital Conservation Buffer	51,401	6.625 %	N/A	N/A
To Be Well Capitalized	62,069	8.000 %	61,818	8.000 %
Tier I Capital (to Average Assets)				
Actual	$86,397	8.894 %	$82,682	8.660 %
For Capital Adequacy Purposes	38,856	4.000 %	38,175	4.000 %
To Be Well Capitalized	48,570	5.000 %	47,719	5.000 %

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Luzerne Bank

(In Thousands)	2016 Amount	2016 Ratio	2015 Amount	2015 Ratio
Common Equity Tier I Capital (to Risk-weighted Assets)				
Actual	$31,102	10.165%	$30,549	10.660%
For Capital Adequacy Purposes	13,769	4.500 %	12,901	4.500 %
Minimum To Maintain Capital Conservation Buffer	15,682	5.125 %	N/A	N/A
To Be Well Capitalized	19,889	6.500 %	18,635	6.500 %
Total Capital (to Risk-weighted Assets)				
Actual	$33,589	10.977%	$33,274	11.610%
For Capital Adequacy Purposes	24,479	8.000 %	22,935	8.000 %
Minimum To Maintain Capital Conservation Buffer	26,391	8.625 %	N/A	N/A
To Be Well Capitalized	30,599	10.000%	28,669	10.000%
Tier I Capital (to Risk-weighted Assets)				
Actual	$31,102	10.165%	$30,549	10.660%
For Capital Adequacy Purposes	18,359	6.000 %	17,201	6.000 %
Minimum To Maintain Capital Conservation Buffer	20,272	6.625 %	N/A	N/A
To Be Well Capitalized	24,479	8.000 %	22,935	8.000 %
Tier I Capital (to Average Assets)				
Actual	$31,102	8.535 %	$30,549	8.900 %
For Capital Adequacy Purposes	14,576	4.000 %	13,725	4.000 %
To Be Well Capitalized	18,220	5.000 %	17,157	5.000 %

NOTE 20 - REGULATORY RESTRICTIONS

The Pennsylvania Banking Code restricts the availability of capital funds for payment of dividends by all state-chartered banks. Accordingly, at December 31, 2016, the balance in the additional paid in capital account totaling $11,657,000 for JSSB and $42,214,000 for Luzerne Bank is unavailable for dividends.

The Banks are subject to regulatory restrictions, which limit the ability to loan funds to Penns Woods Bancorp, Inc. At December 31, 2016, the regulatory lending limit amounted to approximately $16,769,000.

Cash and Due from Banks

Jersey Shore State Bank and Luzerne Bank had no reserve requirements by the district Federal Reserve Bank at December 31, 2016 or 2015; however, if they did they would be reported with cash and due from banks. The required reserves are computed by applying prescribed ratios to the classes of average deposit balances. These are held in the form of cash on hand and a balance maintained directly with the Federal Reserve Bank.

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NOTE 21 - FAIR VALUE MEASUREMENTS

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels of pricing observations are as follows:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level III: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the use of observable market data when available.

The following table presents the assets reported on the balance sheet at their fair value on a recurring basis as of December 31, 2016 and 2015, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	2016			
(In Thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Investment securities, available for sale:				
U.S. Government and agency securities	$—	$—	$ —	$—
Mortgage-backed securities	—	9,313	—	9,313
Asset-backed securities	—	109	—	109
State and political securities	—	60,934	—	60,934
Other debt securities	—	51,118	—	51,118
Financial institution equity securities	10,535	—	—	10,535
Other equity securities	1,483	—	—	1,483
Investment securities, trading:				
Other equity securities	58	—	—	58
Total assets measured on a recurring basis	$12,076	$121,474	$ —	$133,550

	2015			
(In Thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Investment securities, available for sale:				
U.S. Government and agency securities	$—	$3,549	$ —	$3,549
Mortgage-backed securities	—	10,009	—	10,009
Asset-backed securities	—	1,940	—	1,940
State and political securities	—	86,555	—	86,555
Other debt securities	—	57,772	—	57,772
Financial institution equity securities	11,483	—	—	11,483
Other equity securities	4,849	—	—	4,849
Investment securities, trading:				
Financial institution equity securities	73	—	—	73

Total assets measured on a recurring basis	$16,405	$159,825	$ —	$176,230

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The following table presents the assets reported on the balance sheet at their fair value on a non-recurring basis as of December 31, 2016 and 2015, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	2016			
(In Thousands)	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	$—	$—	$13,797	$13,797
Other real estate owned	—	—	839	839
Total assets measured on a non-recurring basis	$—	$—	$14,636	$14,636

	2015			
(In Thousands)	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	$—	$—	$13,779	$13,779
Other real estate owned	—	—	1,696	1,696
Total assets measured on a non-recurring basis	$—	$—	$15,475	$15,475

The following table provides a listing of significant unobservable inputs used in the fair value measurement process for items valued utilizing level III techniques as of December 31, 2016 and 2015:

	2016 Quantitative Information About Level III Fair Value Measurements				
(In Thousands)	Fair Value	Valuation Technique(s)	Unobservable Inputs	Range	Weighted Average
Impaired loans	$5,304	Discounted cash flow	Temporary reduction in payment amount	0 to (70)%	(20)%
			Probability of default	—%	
	8,493	Appraisal of collateral	Appraisal adjustments (1)	0 to (20)%	(15)%
Other real estate owned	$839	Appraisal of collateral (1)			

	2015 Quantitative Information About Level III Fair Value Measurements				
(In Thousands)	Fair Value	Valuation Technique(s)	Unobservable Inputs	Range	Weighted Average
Impaired loans	$5,696	Discounted cash flow	Temporary reduction in payment amount	0 to (70)%	(17)%
			Probability of default	—%	
	8,083	Appraisal of collateral	Appraisal adjustments (1)	0 to (20)%	(15)%
Other real estate owned	$1,696	Appraisal of collateral (1)			

(1) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses.

The significant unobservable inputs used in the fair value measurement of the Company's impaired loans using the discounted cash flow valuation technique include temporary changes in payment amounts and the probability of default. Significant increases (decreases) in payment amounts would result in significantly higher (lower) fair value

measurements. The probability of default is 0% for impaired loans using the discounted cash flow valuation technique because all defaulted impaired loans are valued using the appraisal of collateral valuation technique.

The significant unobservable input used in the fair value measurement of the Company's impaired loans using the appraisal of collateral valuation technique include appraisal adjustments, which are adjustments to appraisals by management for qualitative

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factors such as economic conditions and estimated liquidation expenses. The significant unobservable input used in the fair value measurement of the Company's other real estate owned are the same inputs used to value impaired loans using the appraisal of collateral valuation technique.

NOTE 22 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company is required to disclose fair values for its financial instruments. Fair values are made at a specific point in time, based on relevant market information and information about the financial instrument. These fair values do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Also, it is the Company's general practice and intention to hold most of its financial instruments to maturity and not to engage in trading or sales activities. Because no market exists for a significant portion of the Company's financial instruments, fair values are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These fair values are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions can significantly affect the fair values.

Fair values have been determined by the Company using historical data and an estimation methodology suitable for each category of financial instruments. The Company's fair values, methods, and assumptions are set forth below for the Company's other financial instruments.

As certain assets and liabilities, such as deferred tax assets, premises and equipment, and many other operational elements of the Company, are not considered financial instruments but have value, the fair value of financial instruments would not represent the full market value of the Company.

The fair values of the Company's financial instruments are as follows at December 31, 2016 and 2015:

			Fair Value Measurements at December 31, 2016		
(In Thousands)	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
Financial assets:					
Cash and cash equivalents	$43,671	$43,671	$ 43,671	$ —	$ —
Investment securities:					
Available for sale	133,492	133,492	12,018	121,474	—
Trading	58	58	58		
Loans held for sale	1,953	1,953	1,953	—	—
Loans, net	1,080,785	1,088,122	—	—	1,088,122
Bank-owned life insurance	27,332	27,332	27,332	—	—
Accrued interest receivable	3,672	3,672	3,672	—	—
Financial liabilities:					
Interest-bearing deposits	$791,937	$789,401	$ 571,768	$ —	$ 217,633
Noninterest-bearing deposits	303,277	303,277	303,277	—	—
Short-term borrowings	13,241	13,241	13,241	—	—
Long-term borrowings	85,998	86,353	—	—	86,353
Accrued interest payable	455	455	455	—	—

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(In Thousands)	Carrying Value	Fair Value	Fair Value Measurements at December 31, 2015 Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
Financial assets:					
Cash and cash equivalents	$22,796	$22,796	$ 22,796	$ —	$ —
Investment securities:					
Available for sale	176,157	176,157	16,332	159,825	—
Trading	73	73	73		
Loans held for sale	757	757	757	—	—
Loans, net	1,033,163	1,045,140	—	—	1,045,140
Bank-owned life insurance	26,667	26,667	26,667	—	—
Accrued interest receivable	3,686	3,686	3,686	—	—
Financial liabilities:					
Interest-bearing deposits	$751,797	$729,685	$ 509,206	$ —	$ 220,479
Noninterest-bearing deposits	280,083	280,083	280,083	—	—
Short-term borrowings	46,638	46,638	46,638	—	—
Long-term borrowings	91,025	91,783	—	—	91,783
Accrued interest payable	426	426	426	—	—

Cash and Cash Equivalents, Trading Securities, Loans Held for Sale, Accrued Interest Receivable, Short-term Borrowings, and Accrued Interest Payable:

The fair value is equal to the carrying value.

Investment Securities:

The fair value of investment securities available for sale is equal to the available quoted market price. If no quoted market price is available, fair value is determined by using the quoted market price for similar securities. Regulatory stocks' fair value is equal to the carrying value.

Loans:

Fair values are determined for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial real estate, residential real estate, construction real estate, and other consumer. Each loan category is further segmented into fixed and adjustable rate interest terms and by performing and nonperforming categories.

The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions.

Fair value for significant nonperforming loans is based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discounted rates are judgmentally determined using available

market information and specific borrower information.

Bank-Owned Life Insurance:

The fair value is equal to the cash surrender value of the life insurance policies.

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Deposits:

The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings, NOW, and money market accounts, is equal to the amount payable on demand as of December 31, 2016 and 2015. The fair value of certificates of deposit is based on the discounted value of contractual cash flows.

The fair values above do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market, commonly referred to as the core deposit intangible.

Long Term Borrowings:

The fair value of long term borrowings is based on the discounted value of contractual cash flows.

Commitments to Extend Credit, Standby Letters of Credit, and Financial Guarantees Written:

There is no material difference between the notional amount and the fair value of off-balance sheet items at December 31, 2016 and 2015. The contractual amounts of unfunded commitments and letters of credit are presented in Note 17.

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NOTE 23 - PARENT COMPANY ONLY FINANCIAL STATEMENTS

Condensed financial information for Penns Woods Bancorp, Inc. follows:

CONDENSED BALANCE SHEET, DECEMBER 31,

(In Thousands)	2016	2015
ASSETS:		
Cash	$578	$263
Investment in subsidiaries:		
Bank	129,421	127,126
Non-bank	8,037	8,332
Other assets	373	705
Total Assets	$138,409	$136,426
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Other liabilities	$160	$147
Shareholders' equity	138,249	136,279
Total liability and shareholders' equity	$138,409	$136,426

CONDENSED STATEMENT OF INCOME FOR THE YEARS ENDED DECEMBER 31,

(In Thousands)	2016	2015	2014
Operating income:			
Dividends from subsidiaries	$10,007	$11,367	$10,080
Security gains	—	—	3
Equity in undistributed earnings of subsidiaries	3,128	3,167	5,261
Operating expenses	(660)	(636)	(736)
Net income	$12,475	$13,898	$14,608
Comprehensive income	$11,346	$11,766	$17,835

CONDENSED STATEMENT OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31,

(In Thousands)	2016	2015	2014
OPERATING ACTIVITIES:			
Net income	$12,475	$13,898	$14,608
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	(3,128)	(3,167)	(5,261)
Other, net	344	(313)	(50)
Net cash provided by operating activities	9,691	10,418	9,297
FINANCING ACTIVITIES:			
Dividends paid	(8,903)	(8,967)	(9,055)
Issuance of common stock	101	116	118
Purchase of treasury stock	(574)	(2,603)	(747)
Net cash used for financing activities	(9,376)	(11,454)	(9,684)
NET (DECREASE) INCREASE IN CASH	315	(1,036)	(387)
CASH, BEGINNING OF YEAR	263	1,299	1,686
CASH, END OF YEAR	$578	$263	$1,299

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NOTE 24 - CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)

(In Thousands, Except Per Share Data)	For the Three Months Ended			
2016	March 31,	June 30,	Sept. 30,	Dec. 31,
Interest income	$11,726	$11,669	$11,660	$11,758
Interest expense	1,352	1,381	1,413	1,421
Net interest income	10,374	10,288	10,247	10,337
Provision for loan losses	350	258	258	330
Non-interest income, excluding securities gains	2,522	2,686	2,821	2,415
Securities gains, net	475	492	261	441
Non-interest expense	9,061	8,666	8,739	8,625
Income before income tax provision	3,960	4,542	4,332	4,238
Income tax provision	882	1,152	1,273	1,290
Net income	$3,078	$3,390	$3,059	$2,948
Earnings per share - basic and diluted	$0.65	$0.72	$0.65	$0.62

(In Thousands, Except Per Share Data)	For the Three Months Ended			
2015	March 31,	June 30,	Sept. 30,	Dec. 31,
Interest income	$11,397	$11,529	$11,523	$11,675
Interest expense	1,286	1,307	1,289	1,337
Net interest income	10,111	10,222	10,234	10,338
Provision for loan losses	700	600	520	480
Non-interest income, excluding securities gains	2,599	2,535	2,644	2,417
Securities gains, net	661	522	493	894
Non-interest expense	8,468	8,421	8,530	8,317
Income before income tax provision	4,203	4,258	4,321	4,852
Income tax provision	848	825	957	1,106
Net income	$3,355	$3,433	$3,364	$3,746
Earnings per share - basic and diluted	$0.70	$0.72	$0.71	$0.79

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A CONTROLS AND PROCEDURES

The Company, under the supervision and with the participation of the Company’s management, including the Company’s President and Chief Executive Officer along with the Company’s Chief Financial Officer, conducted an evaluation of the effectiveness as of December 31, 2016 of the design and operation of the Company’s disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Exchange Act. Based upon that evaluation, the Company’s President and Chief Executive Officer along with the Company’s Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of December 31, 2016.

There have been no changes in the Company’s internal control over financial reporting during the fourth quarter of 2016 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Company's internal control over financial reporting is

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designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Auditing Standard No. 2), or a combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course of performing their assigned functions.

Management assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2016. Management’s assessment did not identify any material weaknesses in the Company’s internal control over financial reporting.

In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in "Internal Control-Integrated Framework" issued by COSO in May 2013. Because there were no material weaknesses discovered, management believes that, as of December 31, 2016, the Company’s internal control over financial reporting was effective.

S.R. Snodgrass, P.C. an independent registered public accounting firm, has audited the consolidated financial statements included in this Annual Report on Form 10-K, and, as part of the audit, has issued a report, which appears below, on the effectiveness of the Company’s internal control over financial reporting as of December 31, 2016.

Date: March 7, 2017	/s/ Richard A. Grafmyre	/s/ Brian L. Knepp
	Chief Executive Officer	Chief Financial Officer
		(Principal Financial Officer)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
Penns Woods Bancorp, Inc.
Williamsport, Pennsylvania

We have audited Penns Woods Bancorp, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in 2013. Penns Woods Bancorp, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Report on Management's Assessment of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Penns Woods Bancorp, Inc.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded, as necessary, to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.
In our opinion, Penns Woods Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework issued by COSO in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Penns Woods Bancorp, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2016, and our report dated March 10, 2017, expressed an unqualified opinion.

Cranberry Township, Pennsylvania
March 10, 2017

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ITEM 9B OTHER INFORMATION

None.

PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information appearing under the captions "The Board of Directors and its Committees," "Election of Directors," "Information as to Nominees and Directors," "Section 16(a) Beneficial Ownership Reporting Compliance," "Principal Officers of the Corporation," and "Certain Transactions" in the Company's Proxy Statement for the Company's 2017 annual meeting of shareholders (the "Proxy Statement") is incorporated herein by reference.

ITEM 11 EXECUTIVE COMPENSATION

Information appearing under the captions "Compensation of Directors," "Compensation Discussion and Analysis," "Compensation Committee Report," "Executive Compensation," "Grants of Plan-Based Awards," "Outstanding Equity Awards," "Option Exercises and Stock Vested," "Non-qualified Deferred Compensation," "Retirement Plan," and "Potential Post-Employment Payments" in the Proxy Statement is incorporated herein by reference.

ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information appearing under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement is incorporated herein by reference.

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information appearing under the captions "Election of Directors" and "Certain Transactions" in the Proxy Statement is incorporated herein by reference.

ITEM 14 PRINCIPAL ACCOUNTING FEES AND SERVICES

The information appearing in the Proxy Statement under the captions, "Audit Fees," "Audit-Related Fees," "Tax Fees," "Other Fees," and "Pre-Approval of Audit and Permissible Non-Audit Services" is incorporated herein by reference.

PART IV

ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)1. Financial Statements

The following consolidated financial statements and reports are set forth in Item 8:

Report of Independent Auditors
Consolidated Balance Sheet
Consolidated Statement of Income
Consolidated Statement of Comprehensive Income
Consolidated Statement of Changes in Shareholders' Equity

Consolidated Statement of Cash Flows
Notes to the Consolidated Financial Statements

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2. Financial Statement Schedules

Financial statement schedules are omitted because the required information is either not applicable, not required or is shown in the respective financial statements or in the notes thereto.

(b) Exhibits:

(3) (i)	Articles of Incorporation of the Registrant, as presently in effect (incorporated by reference to Exhibit 3(i) of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005).
(3) (ii)	Bylaws of the Registrant (incorporated by reference to Exhibit 3(ii) of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2011).
(10) (i)	Form of First Amendment to the Jersey Shore State Bank Amendment and Restatement of the Director Fee Agreement, dated as of October 1, 2004 (incorporated by reference to Exhibit 10.7 of the Registrant's Current Report on Form 8-K filed on June 29, 2006).
(10) (ii)	Consulting Agreement, dated July 18, 2005 between Hubert A. Valencik and Penns Woods Bancorp, Inc. (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on July 18, 2005).
(10) (iii)	Amended and Restated Employment Agreement, dated February 1, 2014, among Penns Woods Bancorp, Inc., Jersey Shore State Bank and Brian L. Knepp (incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed on February 6, 2014).*
(10) (iv)	Amended and Restated Employment Agreement, dated November 1, 2014, among Penns Woods Bancorp, Inc., Jersey Shore State Bank and Richard A. Grafmyre (incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed on October 31, 2014).*
(10) (v)	Employment Agreement, dated February 1, 2014, among Penns Woods Bancorp, Inc., Jersey Shore State Bank and Aron M. Carter*
(10) (vi)	Employment Agreement, dated February 1, 2014, among Penns Woods Bancorp, Inc., Jersey Shore State Bank and Michelle M. Karas*
(21)	Subsidiaries of the Registrant.
(23)	Consent of Independent Certified Public Accountants.
(31) (i)	Rule 13a-14(a)/Rule 15d-14(a) Certification of Chief Executive Officer.
(31) (ii)	Rule 13a-14(a)/Rule 15d-14(a) Certification of Principal Financial Officer.
(32) (i)	Section 1350 Certification of Chief Executive Officer.
(32) (ii)	Section 1350 Certification of Principal Financial Officer.
Exhibit 101	Interactive data file containing the following financial statements formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheet at December 31, 2016 and December 31, 2015; (ii) the Consolidated Statement of Income for the years ended December 31, 2016, 2015 and 2014; (iii) the Consolidated Statements of Shareholders' Equity for the years ended December 31, 2016, 2015, and 2014; (iv) the Consolidated Statement of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014; (v) the Consolidated Statement of Cash Flows for the years ended December 31, 2016, 2015, and 2014; and (vi) the Notes to Consolidated Financial Statements, tagged as blocks of text. As provided in Rule 406T of Regulation S-T, this interactive data file shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, and shall not be deemed "filed" or part of any registration statement or prospectus for purposes of Section 11 or 12 under the Securities Act of 1933, or otherwise subject to liability under those sections.

* Denotes compensatory plan or arrangement.

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EXHIBIT INDEX

(10) (v)	Employment Agreement, dated February 1, 2014, among Penns Woods Bancorp, Inc., Jersey Shore State Bank and Aron M. Carter*
(10) (vi)	Employment Agreement, dated February 1, 2014, among Penns Woods Bancorp, Inc., Jersey Shore State Bank and Michelle M. Karas*
(21)	Subsidiaries of the Registrant.
(23)	Consent of Independent Certified Public Accountants.
(31) (i)	Rule 13a-14(a)/Rule 15d-14(a) Certification of Chief Executive Officer.
(31) (ii)	Rule 13a-14(a)/Rule 15d-14(a) Certification of Principal Financial Officer.
(32) (i)	Section 1350 Certification of Chief Executive Officer.
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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

March 7, 2017 PENNS WOODS BANCORP, INC.
/s/ Richard A. Grafmyre
President and Chief Executive Officer

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Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

/s/ Richard A. Grafmyre Richard A. Grafmyre, President, Chief Executive Officer and Director (Principal Executive Officer)	March 7, 2017
/s/ Brian L. Knepp Brian L. Knepp, Chief Financial Officer and Director (Principal Financial and Accounting Officer)	March 7, 2017
/s/ R. Edward Nestlerode, Jr. R. Edward Nestlerode, Jr., Chairman of the Board	March 7, 2017
/s/ Daniel K. Brewer Daniel K. Brewer, Director	March 7, 2017
/s/ Michael J. Casale, Jr. Michael J. Casale, Jr., Director	March 7, 2017
/s/ William J. Edwards William J. Edwards, Director	March 7, 2017
/s/ James M. Furey, II James M. Furey, II, Director	March 7, 2017
/s/ D. Michael Hawbaker D. Michael Hawbaker, Director	March 7, 2017
/s/ Leroy H. Keiler, III Leroy H. Keiler, III, Director	March 7, 2017
/s/ Joseph E. Kluger Joseph E. Kluger, Director	March 7, 2017
/s/ John G. Nackley John G. Nackley, Director	March 7, 2017
/s/ Jill F. Schwartz Jill F. Schwartz, Director	March 7, 2017
/s/ William H. Rockey William H. Rockey, Director	March 7, 2017
/s/ Hubert A. Valencik Hubert A. Valencik, Director	March 7, 2017
/s/ Ronald A. Walko Ronald A. Walko, Director	March 7, 2017