CHEMUNG FINANCIAL CORP
Form 10-Q
November 14, 2011

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

FORM 10-Q

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

For Quarterly period ended September 30, 2011
Or

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

Commission File No. 0-13888

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

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

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

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

YES: X NO:____

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

YES: X NO:____

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

Large accelerated filer	[ ]	Non-accelerated filer	[ ]
Accelerated filer	[ ]	Smaller reporting company	[X]

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

YES: ____ NO: X

The number of shares of the registrant's common stock, $.01 par value, outstanding on October 31, 2011 was 4,569,710.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION
Item 1: Financial Statements

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	SEPTEMBER 30, 2011	DECEMBER, 31, 2010
ASSETS		
Cash and due from financial institutions	$ 30,748,786	$ 16,540,095
Interest-bearing deposits in other financial institutions	87,723,958	44,079,682
Total cash and cash equivalents	118,472,744	60,619,777
Securities available for sale, at estimated fair value	279,078,596	223,544,961
Securities held to maturity, estimated fair value of $8,483,553 at September 30, 2011 and $8,297,392 at December 31, 2010	7,585,671	7,715,123
Federal Home Loan Bank and Federal Reserve Bank Stock, at cost	5,672,450	3,328,900
Loans, net of deferred origination fees and costs, and unearned income	788,458,576	613,684,369
Allowance for loan losses	(9,676,923)	(9,498,131)
Loans, net	778,781,653	604,186,238
Loans held for sale	74,412	486,997
Premises and equipment, net	24,250,065	24,192,593
Goodwill	22,157,213	9,872,375
Other intangible assets, net	6,478,541	4,655,900
Bank owned life insurance	2,602,647	2,536,715
Other assets	20,768,574	17,187,706
Total assets	$ 1,265,922,566	$ 958,327,285
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	$ 261,945,489	$ 197,322,036
Interest-bearing	780,260,416	589,036,816
Total deposits	1,042,205,905	786,358,852

Securities sold under agreements to repurchase	41,453,658	44,774,615
Federal Home Loan Bank term advances	43,936,174	20,000,000
Accrued interest payable	822,970	784,351
Dividends payable	1,142,015	881,203
Other liabilities	7,674,121	8,119,701
Total liabilities	1,137,234,843	860,918,722
Shareholders' equity:		
Common stock, $.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at September 30, 2011 and 4,300,134 issued at December 31, 2010	53,101	43,001
Additional-paid-in capital	45,709,779	22,022,122
Retained earnings	98,808,285	94,407,620
Treasury stock, at cost (742,518 shares at September 30, 2011; 749,880 shares at December 31, 2010)	(18,948,660)	(19,166,655)
Accumulated other comprehensive income	3,065,218	102,475
Total shareholders' equity	128,687,723	97,408,563
Total liabilities and shareholders' equity	$ 1,265,922,566	$ 958,327,285

See accompanying notes to unaudited consolidated financial statements.

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

	Nine Months Ended		Three Months Ended	
	September 30,	September 30,	September 30,	September 30,
INTEREST AND DIVIDEND INCOME	2011	2010	2011	2010
Loans, including fees	$31,456,406	$26,412,468	$11,673,215	$ 8,742,046
Taxable securities	4,347,409	4,968,287	1,504,393	1,555,301
Tax exempt securities	1,035,068	888,938	350,557	300,917
Interest-bearing deposits	166,955	123,984	65,139	41,709
Total interest and dividend income	37,005,838	32,393,677	13,593,304	10,639,973
INTEREST EXPENSE				
Deposits	3,325,900	4,452,535	1,138,130	1,335,770
Borrowed funds	783,022	711,231	285,084	239,634
Securities sold under agreements to repurchase	1,056,095	1,257,428	326,542	383,095
Total interest expense	5,165,017	6,421,194	1,749,756	1,958,499
Net interest income	31,840,821	25,972,483	11,843,548	8,681,474
Provision for loan losses	833,333	1,125,000	583,333	375,000
Net interest income after provision for loan losses	31,007,488	24,847,483	11,260,215	8,306,474
Other operating income:				
Wealth management group fee income	5,131,119	6,256,974	1,746,958	2,183,765
Service charges on deposit accounts	3,180,733	3,428,277	1,130,824	1,106,415
Net gain on securities transactions	1,108,091	451,094	428,882	-
Other-than-temporary loss on investment securities:				
Total impairment losses	(67,400)	(393,005)	(67,400)	(56,380)
Loss recognized in other comprehensive income	-	-	-	-
Net impairment loss recognized in earnings	(67,400)	(393,005)	(67,400)	(56,380)
	132,902	166,247	53,571	32,681

Net gain on sales of loans held for sale				
Credit card merchant earnings	162,215	148,107	57,153	48,937
Gains on sales of other real estate owned	89,404	33,550	442	-
Income from bank owned life insurance	65,932	65,213	22,321	22,075
Other	3,617,016	2,750,745	955,712	909,951
Total other operating income	13,420,012	12,907,202	4,328,463	4,247,444
Other operating expenses:				
Salaries and wages	12,534,214	11,362,716	4,272,612	3,768,761
Pension and other employee benefits	3,296,814	2,828,493	1,172,044	809,940
Net occupancy expenses	3,663,005	3,272,432	1,230,490	1,065,930
Furniture and equipment expenses	1,549,048	1,441,030	486,518	465,262
Data processing expense	2,881,150	2,457,347	976,050	822,341
Amortization of intangible assets	753,192	550,531	288,001	180,363
Losses on sales of other real estate owned	1,671	17,983	-	(7,575)
Other real estate owned expenses	86,040	305,147	37,549	112,307
FDIC insurance	737,281	912,652	294,897	287,298
Merger related expenses	2,243,919	-	20,500	-
Other	5,515,652	4,395,221	1,838,726	1,378,395
Total other operating expenses	33,261,986	27,543,552	10,617,387	8,883,022
Income before income tax expense	11,165,514	10,211,133	4,971,291	3,670,896
Income tax expense	3,589,455	3,157,001	1,680,351	1,119,960
Net income	$ 7,576,059	$ 7,054,132	$ 3,290,940	$ 2,550,936
Weighted average shares outstanding	4,297,777	3,604,502	4,637,392	3,602,277
Basic and diluted earnings per share	$ 1.76	$ 1.96	$ 0.71	$ 0.71

See accompanying notes to unaudited consolidated financial statements.

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

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balances at December 31, 2009	$ 43,001	$ 22,806,829	$ 87,826,331	$ (20,024,661)	$ (565,835)	$ 90,085,665
Comprehensive Income:						
Net income	-	-	7,054,132	-	-	7,054,132
Change in unrealized gains(losses) on securities AFS, net	-	-	-	-	2,633,416	2,633,416
Change in funded status of Employers' Accounting for Defined Benefit Pension and Other Benefit Plans, net	-	-	-	-	231,937	231,937
Total comprehensive income (loss)	-	-	-	-	-	9,919,485
Restricted stock units for directors' deferred compensation plan	-	83,311	-	-	-	83,311
Cash dividends declared ($.75 per share)	-	-	(2,639,382)	-	-	(2,639,382)
Distribution of 10,082 shares of treasury stock for directors' compensation	-	(44,677)	-	258,906	-	214,229
Distribution of 2,750 shares of treasury stock for employee compensation	-	(15,537)	-	70,537	-	55,000
Purchase of 20,260 shares of treasury stock	-	-	-	(425,566)	-	(425,566)
Balances at September 30, 2010	$ 43,001	$ 22,829,926	$ 92,241,081	$ (20,120,784)	$ 2,299,518	$ 97,292,742
Balances at December 31, 2010	$ 43,001	$ 22,022,122	$ 94,407,620	$ (19,166,655)	$ 102,475	$ 97,408,563

Comprehensive Income:						
Net income	-	-	7,576,059	-	-	7,576,059
Change in unrealized gains (losses) on securities AFS, net		-	-	-	2,678,187	2,678,187
Change in funded status of Employers' Accounting for Defined Benefit Pension and Other Benefit Plans, net	-	-	-	-	284,556	284,556
Total comprehensive income (loss)	-	-	-	-	-	10,538,802
Restricted stock awards	-	21,226	-	-	-	21,226
Restricted stock units for directors' deferred compensation plan	-	61,129	-	-	-	61,129
Cash dividends declared ($.75 per share)	-	-	(3,175,394)	-	-	(3,175,394)
Distribution of 10,378 shares of treasury stock for directors' compensation	-	(33,831)	-	265,262	-	231,431
Distribution of 2,392 shares of treasury stock for employee compensation	-	(6,140)	-	61,140	-	55,000
Distribution of 286 shares of treasury stock for director’s deferred compensation	-	(7,364)	-	7,310	-	(54)
Distribution of 4,387 shares of treasury stock for employee restricted stock warrants	-	(60,800)	-	112,090	-	51,290
Purchase of 13,981 shares of treasury stock	-	-	-	(327,413)	-	(327,413)
Sale of 3,900 shares of treasury stock	-	(10,101)	-	99,606	-	89,505
Issuance of 1,009,942 shares related to FOFC	10,100	23,723,538	-	-	-	23,733,638

Merger						
Balances at September 30, 2011	$ 53,101	$ 45,709,779	$ 98,808,285	$ (18,948,660)	$ 3,065,218	$ 128,687,723

See accompanying notes to unaudited consolidated financial statements.

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

	Nine Months Ended September 30,	
CASH FLOWS FROM OPERATING ACTIVITIES:	2011	2010
Net income	$ 7,576,059	$ 7,054,132
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	753,192	550,531
Provision for loan losses	833,333	1,125,000
Depreciation and amortization of fixed assets	2,129,738	2,057,825
Amortization of premiums on securities, net	960,973	489,661
Gains on sales of loans held for sale, net	(132,902)	(166,247)
Proceeds from sales of loans held for sale	5,523,214	5,686,897
Loans originated and held for sale	(4,977,727)	(5,906,757)
Net gain on sale of other real estate owned	(87,733)	(15,568)
Net gains on securities transactions	(1,108,091)	(451,094)
Net impairment loss recognized on investment securities	67,400	393,005
Decrease in other assets	2,752,047	671,468
(Increase) decrease in prepaid FDIC assessment	(49,464)	819,241
Decrease in accrued interest payable	(265,000)	(235,220)
Expense related to restricted stock units for directors' deferred compensation plan	61,129	83,311
Expense related to employee stock compensation	55,000	55,000
Expense related to employee stock awards	21,226	-
Decrease in other liabilities	(2,243,010)	(2,987,293)
Income from bank owned life insurance	(65,932)	(65,213)
Proceeds from sales of student loans	-	137,509
Net cash provided by operating activities	11,803,452	9,296,188
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and calls of securities available for sale	67,741,210	50,440,459
	23,608,123	49,260,195

Proceeds from maturities and principal collected on securities available for sale		
Proceeds from maturities and principal collected on securities held to maturity	3,448,732	9,561,278
Purchases of securities available for sale	(95,911,022)	(110,793,064)
Purchases of securities held to maturity	(3,319,281)	(5,429,297)
Purchase of Federal Home Loan Bank and Federal Reserve Bank stock	(1,002,500)	(58,200)
Redemption of Federal Home Loan Bank and Federal Reserve Bank stock	237,250	-
Purchases of premises and equipment	(1,307,723)	(1,230,458)
Cash paid Fort Orange Financial Corp. acquisition	(8,137,816)	-
Cash received Fort Orange Financial Corp. acquisition	33,284,995	-
Proceeds from sale of other real estate owned	356,207	236,102
Net (increase) decrease in loans	(10,967,168)	3,210,362
Net cash provided (used) by investing activities	8,031,007	(4,802,623)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits, NOW accounts, savings accounts, and insured money market accounts	70,452,474	17,197,567
Net decrease in time deposits and individual retirement accounts	(15,073,756)	(14,749,680)
Net decrease in securities sold under agreements to repurchase	(13,889,730)	(10,497,579)
Net decrease in Federal Home Loan Bank long term advances	(317,990)	-
Purchase of treasury stock	(327,413)	(425,566)
Sale of treasury stock	89,505	-
Cash dividends paid	(2,914,582)	(2,641,239)
Net cash provided (used) by financing activities	38,018,508	(11,116,497)
Net increase (decrease) in cash and cash equivalents	57,852,967	(6,622,932)
Cash and cash equivalents, beginning of period	60,619,777	79,738,396
Cash and cash equivalents, end of period	$ 118,472,744	$ 73,115,464
See accompanying notes to unaudited consolidated financial statements.		

(Cash Flow continued)

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Supplemental disclosure of cash flow information:				
Cash paid during the year for:				
Interest	$	5,126,397	$	6,656,414
Income Taxes	$	3,340,847	$	4,575,675
Supplemental disclosure of non-cash activity:				
Transfer of loans to other real estate owned	$	308,976	$	554,246

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

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

The data in the consolidated balance sheet as of December 31, 2010 was derived from the audited consolidated financial statements in the Corporation's 2010 Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 16, 2011. That data, along with the other interim financial information presented in the consolidated balance sheets, statements of income, shareholders' equity and comprehensive income, and cash flows should be read in conjunction with the audited consolidated financial statements, including the notes thereto, contained in the 2010 Annual Report on Form 10-K. Amounts in prior periods' consolidated interim financial statements are reclassified whenever necessary to conform to the current period's presentation.

The consolidated financial statements included herein reflect all adjustments which are, in the opinion of management, of a normal recurring nature and necessary to present fairly the Corporation's financial position as of September 30, 2011 and December 31, 2010, and results of operations for the three and nine-month periods ended September 30, 2011 and 2010, and changes in shareholders' equity and cash flows for the nine-month periods ended September 30, 2011 and 2010. Subsequent events were evaluated for any required recognition or disclosure. The results for the periods presented are not necessarily indicative of results to be expected for the entire fiscal year or any other interim period.

2. Earnings Per Common Share

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares including those related to directors' restricted stock units and directors' stock compensation are considered outstanding and are included in the computation of basic earnings per share as they are earned. All outstanding unvested share based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities. The impact of the participating securities on earnings per share is not material. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,297,777 and 3,604,502 weighted average shares outstanding for the nine-month periods ended September 30, 2011 and 2010, and 4,637,392 and 3,602,277 weighted average shares outstanding for the three-month periods ended September 30, 2011 and 2010, respectively. There were no dilutive common stock equivalents during the three and nine-month periods ended September 30, 2011 or 2010.

3. Fair Value

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

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

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

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

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

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

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

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals and collateral evaluations. The appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by third party appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Non-recurring adjustments to certain commercial and residential real estate properties classified as other real estate owned ("OREO") are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value less costs to sell, an impairment loss is recognized.

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

		Fair Value Measurement at September 30, 2011 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U.S. Government and U.S. Government sponsored enterprises	$ 142,948,508	$ 36,088,000	$ 106,860,508	$ -
Mortgage-backed securities, residential	57,220,655	-	57,220,655	-
Obligations of states and political subdivisions	46,636,291	-	46,636,291	-
Trust Preferred securities	2,280,848	-	1,985,938	294,910
Corporate bonds and notes	13,792,147	-	13,792,147	-
CMO’s	8,468,507	-	8,468,507	-
SBA Pool’s	2,305,718	-	2,305,718	-
Corporate stocks	5,425,922	4,741,501	684,421	-
Total available for sale securities	$ 279,078,596	$ 40,829,501	$ 237,954,185	$ 294,910

		Fair Value Measurement at December 31, 2010 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U.S. Government and U.S. Government sponsored enterprises	$ 102,131,517	$ 40,581,250	$ 61,550,267	$ -
Mortgage-backed securities, residential	62,761,633	-	62,761,633	-
	38,765,092	-	38,765,092	-

Obligations of states and political subdivisions				
Trust Preferred securities	2,344,094	-	2,009,509	334,585
Corporate bonds and notes	11,694,190	-	11,694,190	-
Corporate stocks	5,848,435	5,209,069	639,366	-
Total available for sale securities	$ 223,544,961	$ 45,790,319	$ 177,420,057	$ 334,585

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The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine-month periods ending September 30, 2011 and 2010:

	Fair Value Measurement nine-months ended September 30, 2011 Using Significant Unobservable Inputs (Level 3)	Fair Value Measurement nine-months ended September 30, 2010 Using Significant Unobservable Inputs (Level 3)
Investment Securities Available for Sale		
Beginning balance	$ 334,585	$ 511,480
Total gains/losses (realized/unrealized):		
Included in earnings:		
Income on securities	-	-
Impairment charge on investment securities	(67,400)	(393,005)
Included in other comprehensive income	27,725	172,340
Transfers in and/or out of Level 3	-	-
Ending balance September 30	$ 294,910	$ 290,815

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

		Fair Value Measurement at September 30, 2011 Using		
Financial Assets:	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans:				
Commercial, financial and agricultural:				
Commercial and industrial	$ 701,710	$ -	$ -	$ 701,710
Commercial mortgages:	407,551	-	-	407,551
Other	392,257	-	-	392,257
Total Impaired Loans	$ 1,501,578	$ -	$ -	$ 1,501,578
Other real estate owned, net	$ 661,475	$ -	$ -	$ 661,475

Financial Assets:	Fair Value	Fair Value Measurement at December 31, 2010 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired Loans:				
Commercial mortgages:				
Construction	$ 72,211	$ -	$ -	$ 72,211
Other	580,329	-	-	580,329
Total Impaired Loans	$ 652,540	$ -	$ -	$ 652,540
Other real estate owned, net	$ 740,620	$ -	$ -	$ 740,620

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $3,088,321 with a valuation allowance of $1,586,743 as of September 30, 2011, resulting in a $833,333 provision for loan losses for the nine-month period ending September 30, 2011. Impaired loans had a carrying amount of $892,298, with a valuation allowance of $239,758 as of December 31, 2010, resulting in no additional provision for loan losses for the year ending December 31, 2010.

OREO, which is measured by the lower of carrying or fair value less costs to sell, had a net carrying amount of $661,475 at September 30, 2011. The net carrying amount reflects the outstanding balance of $784,162 net of a valuation allowance of $122,687 at September 30, 2011 which resulted in write downs of $12,120 for the nine-month period ending September 30, 2011. OREO had a net carrying amount of $740,620 at December 31, 2010. The net carrying amount reflected an outstanding balance of $909,947, net of a valuation allowance of $169,327 at December 31, 2010 which resulted in write downs of $169,327 for the year ending December 31, 2010.

The carrying amounts and estimated fair values of other financial instruments, at September 30, 2011 and December 31, 2010, are as follows:

(dollars in thousands)	September 30, 2011		December 31, 2010	
Financial assets:	Carrying Amount	Estimated Fair Value (1)	Carrying Amount	Estimated Fair Value (1)
Cash and due from financial institutions	$ 30,749	$ 30,749	$ 16,540	$ 16,540
Interest-bearing deposits in other financial institutions	87,724	87,724	44,080	44,080
Securities available for sale	279,079	279,079	223,545	223,545
Securities held to maturity	7,586	8,484	7,715	8,297
Federal Home Loan and Federal Reserve Bank stock	5,672	N/A	3,329	N/A
Net loans	778,782	798,889	604,186	618,859
Loans held for sale	74,412	74,412	487	487
Accrued interest receivable	4,001	4,001	2,713	2,713
Financial liabilities:				
Deposits:				
Demand, savings, and insured money market accounts	736,711	736,711	532,555	532,555
Time deposits	305,495	307,978	253,804	256,281
Securities sold under agreements to repurchase	41,454	43,975	44,775	46,667
Federal Home Loan Bank advances	43,936	47,452	20,000	21,609

Accrued interest payable	823	823	784	784
Dividends payable	1,142	1,142	881	881

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

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

Carrying amount is the estimated fair value for cash and due from financial institutions, interest bearing deposits, accrued interest receivable and payable, demand deposits, short-term debt, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities were described previously. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance-sheet items is not considered material.

4. Goodwill and Intangible Assets

The changes in goodwill included in the core banking segment during the periods ending September 30, 2011 and 2010 were as follows:

	2011	2010
Beginning of year	$ 9,872,375	$ 9,872,375
Acquired goodwill	12,284,838	-
September 30,	$ 22,157,213	$ 9,872,375

Acquired intangible assets were as follows at September 30, 2011 and December 31, 2010:

	At September 30, 2011		At December 31, 2010	
	Balance Acquired	Accumulated Amortization	Balance Acquired	Accumulated Amortization
Core deposit intangibles	$ 3,819,798	$ 1,050,211	$ 1,174,272	$ 674,141
Other customer relationship intangibles	6,063,423	2,354,469	6,133,116	1,977,347
Total	$ 9,883,221	$ 3,404,680	$ 7,307,388	$ 2,651,488

Aggregate amortization expense was $753,192 and $550,531 for the-nine month periods ended September 30, 2011 and 2010, respectively.

The remaining estimated aggregate amortization expense at September 30, 2011 is listed below:

Year	Estimated Expense
2011	$ 288,001
2012	1,046,720
2013	876,524
2014	777,801
2015	681,176
	2,808,319

2016 and thereafter		
Total	$	6,478,541

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5. Business Combinations

Acquisition of Fort Orange Financial Corp.

On April 8, 2011, the Corporation completed its merger with Fort Orange Financial Corp. ("FOFC"), the holding company of Capital Bank & Trust Company ("Capital Bank") based in Albany, New York, with FOFC being merged with and into the Corporation, and the Corporation being the surviving entity. Immediately following the merger, Capital Bank was merged with and into the Bank.

As of the date of the merger, Capital Bank's unaudited balance sheet included approximately $254 million in assets, a loan portfolio approximating $171 million and deposits of $199 million. With the completion of the acquisition, the Corporation became a $1.2 billion financial institution with 28 offices located in eight New York counties, as well as Bradford County in Pennsylvania. The Capital Bank branch locations are in Albany, Clifton Park, Latham and Slingerlands.

Under the terms of an Agreement and Plan of Merger (the "Agreement") entered into on October 14, 2010, the Corporation purchased all of the outstanding shares of FOFC common stock in a stock and cash transaction valued at $31.9 million, based upon the Corporation's closing stock price on April 8, 2011 of $23.50. For each share of FOFC common stock outstanding immediately prior to the merger, each FOFC shareholder had the right to elect to receive: (i) all cash in the amount of $7.50 per share ("Cash Consideration"), (ii) all stock at an exchange ratio of 0.3571 of a share of the Corporation's common stock for each share of FOFC common stock ("Stock Consideration") or (iii) a mix of Cash Consideration for 25% of their shares and Stock Consideration for 75% of their shares. The total consideration to be paid by the Corporation was subject to the requirement that 25% of the FOFC common stock be acquired for the Cash Consideration and 75% be acquired for the Stock Consideration. As a result of the merger, the Corporation issued approximately 1.01 million additional shares of its common stock.

The table below illustrates the reconciliation of shares outstanding and the calculation of the consideration effectively transferred.

Reconciliation of Shares Outstanding	
FOFC shares outstanding at April 8, 2011	3,771,425
Percentage of stock consideration	75%
FOFC shares exchanged for stock	2,828,569
Exchange Ratio	0.3571
Chemung Financial shares issued to FOFC shareholders (excludes fractional shares)	1,009,942
Chemung Financial shares outstanding April 8, 2011	3,565,610
Total Chemung Financial Shares at April 8, 2011 following the consummation of the transaction	4,575,552
Ownership % held by FOFC shareholders	22%
Ownership % held by legacy Chemung Financial shareholders	78%

Purchase Price Consideration (dollar amounts in thousands, except per share data)		
FOFC shares outstanding at April 8, 2011		3,771,425
Percentage of stock consideration		75%
FOFC shares exchanged for stock		2,828,569
Exchange Ratio		0.3571
Chemung Financial shares issued to FOFC shareholders (excludes fractional shares)		1,009,942
Purchase price per Chemung Financial common share	$	23.50
Total stock consideration paid	$	23,734
Total cash consideration paid		6,939
Cash paid for fractional shares		3
Cash paid for the settlement of FOFC stock options		545
Cash paid for severance payments		650
Total consideration paid	$	31,871

As a result of the FOFC merger, we recognized assets acquired and liabilities assumed at their acquisition date fair value as presented below: (in thousands).

Total Purchase Price			$ 31,871
Net assets acquired:			
Cash and due from banks	$	33,285	
Securities available for sale		46,525	
Federal Home Loan Bank Stock		1,578	
Loans		164,153	
Accrued Interest Receivable		864	
Premises and equipment		879	
Core deposit intangible		2,646	
Deferred tax asset		2,466	
Other assets		3,530	
Deposits		(200,468)	
Borrowings		(34,823)	
Accrued Interest Payable		(304)	
Other liabilities		(745)	
Net assets acquired			$ 19,586
Goodwill resulting from the FOFC merger			$ 12,285

The goodwill generated by the FOFC merger consists of, among other things, synergies and increased economies of scale, including the ability to offer more diverse and profitable products, greater diversity in the branch system which may lead to lower cost deposits, and an increased legal lending limit. We expect that no goodwill recognized as a result of the FOFC merger will be deductible for income tax purposes. Purchase accounting adjustments are subject to refinement as management finalizes their fair value measurements, including their analysis of identifiable intangible assets. Since the branches acquired were merged into the Bank, there is no segment impact of the FOFC merger.

The fair value of the financial assets acquired included loans receivable with an unpaid principal balance of $170.7 million. U.S. generally accepted accounting principles ("U.S. GAAP") prohibits carrying over an allowance for loan losses for loans purchased in the merger. The table below illustrates the fair value adjustments made to the unpaid principal balance in order to present a fair value of the loans acquired (in thousands).

Gross loans-unpaid principal balance at April 8, 2011	$	170,682
Fair value adjustment on pools of homogeneous loans		(1,619)
Credit fair value adjustment on loans with deteriorating credit quality		(4,820)
Fair value of purchased loans at April 8, 2011	$	164,243

The fair value adjustment on pools of homogeneous loans represents adjustments a prospective acquirer would make to the unpaid principal balance to account for differences between the contractual yield on the portfolio and market interest rates, for credit, and for liquidity. The market rate adjustment represents the movement in market interest rates, irrespective of credit adjustments, compared to the stated rates of the acquired loans. The credit adjustment made on pools of homogeneous loans represents the changes in credit quality of the underlying borrowers from the loan inception to the merger date. The credit adjustment on loans with deteriorating credit quality is derived in accordance with Accounting Standard Codification 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality" and represents the portion of the loan balance that has been deemed uncollectible based on our expectations of future cash flows for each respective loan.

The information below presents the recorded fair value on April 8, 2011 of the Corporation's purchased impaired loans with the accretable and non-accretable related adjustments from the perspective of total contractual cash flows (in thousands).

Contractually required principal and interest at acquisition	$	25,718
Contractual cash flows not expected to be collected (nonaccretable discount)		(5,849)
Expected cash flows at acquisition		19,869
Interest component of expected cash flows (accretable yield)		(1,861)
Fair value of loans acquired with deteriorating credit quality	$	18,008

The results of operations of the merged entity have been reflected in Chemung Financial Corporation's consolidated statements of income beginning as of the acquisition date. Pro forma condensed consolidated income statements for the three and nine months ended September 30, 2011 and 2010 as if the merger occurred at the beginning of each period presented are as follows (in thousands):

	Nine Months Ended September 30,	
Financial assets:	2011	2010
Interest and dividend income	$40,414	$42,529

Interest expense	6,025	9,660
Net interest income	34,389	32,869
Provision for loan losses	1,808	2,375
Net interest income after provision for loan losses	32,581	30,494
Non-interest income	$13,472	$13,349
Non-interest expense	32,777	32,117
Income before income taxes	13,276	11,726
Income tax expense	4,406	3,742
Net income	$ 8,870	$ 7,984
Weighted average shares outstanding	4,629	4,614
Basic and diluted earnings per share	$ 1.92	$ 1.73

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The consolidated income statement for the Corporation includes $5.654 million of net interest income, $72 thousand of non-interest income and net income of $2.314 million of the acquiree since the acquisition date.

6. Comprehensive Income

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

Comprehensive income for the three and nine-month periods ended September 30, 2011 was $3,297,441 and $10,538,802, respectively. Comprehensive income for the three and nine-month periods ended September 30, 2010 was $3,393,701 and $9,919,485, respectively. The following summarizes the components of other comprehensive income:

	Nine Months Ended September 30,		Three Months Ended September 30,	
Other Comprehensive Income	2011	2010	2011	2010
Unrealized holding gains on securities available for sale	$ 5,448,351	$4,573,717	$ 294,210	$1,400,082
Change in unrealized gains (losses) on securities available for sale for which a portion of an other-than-temporary impairment has been recognized in earnings, net of reclassification	27,725	172,340	(9,425)	(50,760)
Reclassification adjustment net gains realized in net income	(1,108,091)	(451,094)	(428,882)	-
Net unrealized gains (losses)	4,367,985	4,294,963	(144,097)	1,349,322
Tax effect	1,689,798	1,661,547	(55,746)	521,998
Net of tax amount	$ 2,678,187	$2,633,416	$ (88,351)	$ 827,324
Change in funded status of defined benefit pension plan and other benefit plans	464,097	378,277	154,699	25,183
Tax effect	179,541	146,340	59,847	9,742
Net of tax amount	284,556	231,937	94,852	15,441
Total other comprehensive income	$ 2,962,743	$2,865,353	$ 6,501	$ 842,765

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

	Balance at December 31, 2010	Current Period Change	Balance at September 30, 2011

Unrealized gains on securities available for sale	$ 5,661,013	$ 2,678,187	$ 8,339,200
Unrealized loss on pension plans and other benefit plans	(5,558,538)	284,556	(5,273,982)
Total	$ 102,475	$ 2,962,743	$ 3,065,218

7. Commitments and Contingencies

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

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

8. Securities

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

	September 30, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	$ 139,497,422	$ 3,476,346	$ 25,260	$ 142,948,508
Mortgage-backed securities, residential	54,007,115	3,214,050	510	57,220,655
Collateralized Mortgage obligations	8,285,864	183,403	760	8,468,507
Obligations of states and political subdivisions	44,622,411	2,017,069	3,189	46,636,291
Corporate bonds and notes	13,475,088	476,400	159,341	13,792,147
SBA loan pools	2,265,412	40,306	-	2,305,718
	2,536,347	105,236	360,735	2,280,848

Trust Preferred securities				
Corporate stocks	788,129	4,652,367	14,574	5,425,922
Total	$ 265,477,788	$ 14,165,177	$ 564,369	$ 279,078,596

	December 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government and U.S. Government sponsored enterprises	$ 101,426,799	$ 916,547	$ 211,829	$ 102,131,517
Mortgage-backed securities, residential	60,379,269	2,385,036	2,672	62,761,633
Obligations of states and political subdivisions	38,143,972	672,067	50,947	38,765,092
Corporate bonds and notes	11,019,343	674,847	-	11,694,190
Trust Preferred securities	2,597,993	134,561	388,460	2,344,094
Corporate stocks	744,763	5,112,755	9,082	5,848,435
Total	$ 214,312,139	$ 9,895,813	$ 662,990	$ 223,544,961

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

	September 30, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	$ 7,585,671	$ 897,882	$ -	$ 8,483,553
Total	$ 7,585,671	$ 897,882	$ -	$ 8,483,553

	December 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Obligations of states and political subdivisions	$ 7,715,123	$ 582,269	$ -	$ 8,297,392
Total	$ 7,715,123	$ 582,269	$ -	$ 8,297,392

The amortized cost and estimated fair value of debt securities are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties:

	September 30, 2011			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within One Year	$ 45,528,688	$ 45,906,777	$ 2,048,903	$ 2,083,328
After One, But Within Five Years	193,393,110	200,601,911	3,580,269	4,007,464

After Five, But Within Ten Years	21,308,173	22,862,763	1,956,499	2,392,761
After Ten Years	4,459,688	4,281,223	-	-
Total	$ 264,689,659	$ 273,652,674	$ 7,585,671	$ 8,483,553

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

Proceeds from sales and calls of securities available for sale for the three and nine months ended September 30, 2010, were $20,000,000 and $50,440,459, respectively. There were no realized gross gains on these sales and calls were during the three month period ended September 30, 2010 and realized gross gains on these sales and calls were $451,094 during nine month period ended September 30, 2010. There were no sales or calls of securities available for sale that resulted in losses for the three or nine-months ended September 30, 2010.

The following table summarizes the investment securities available for sale and held to maturity with unrealized losses at September 30, 2011 and December 31, 2010 by aggregated major security type and length of time in a continuous unrealized loss position:

	Less than 12 months		12 months or longer		Total	
September 30, 2011	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government and U.S. Government sponsored enterprises	$ 14,874,740	25,260	$ -	$ -	$ 14,874,740	$ 25,260
Mortgage-backed securities, residential	187,675	$ 510	-	-	187,675	510
Collateralized mortgage obligations	1,167,696	760	-	-	1,167,696	760
Obligations of states and political subdivisions	363,989	3,189	-	-	363,989	3,189
Corporate bonds and notes	5,308,085	159,341	-	-	5,308,085	159,341
Trust preferred securities	-	-	294,910	360,735	294,910	360,735
Corporate stocks	3,353	285	35,703	14,289	39,056	14,574
Total temporarily impaired securities	$ 21,905,538	$ 189,345	$ 330,613	$ 375,024	$ 22,236,151	$ 564,369

	Less than 12 months		12 months or longer		Total	
December 31, 2010	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government	$ 25,543,154	$ 211,829	$ -	$ -	$ 25,543,154	$ 211,829

and U.S. Government sponsored enterprises						
Mortgage-backed securities, residential	844,587	2,672	-	-	844,587	2,672
Obligations of states and political subdivisions	7,746,912	50,947	-	-	7,746,912	50,947
Trust preferred securities	-	-	334,585	388,460	334,585	388,460
Corporate stocks	-	-	40,910	9,082	40,910	9,082
	$ 34,134,653	$ 265,448	$ 375,495	$ 397,542	$ 34,510,148	$ 662,990

Other-Than-Temporary Impairment

In determining OTTI for debt securities, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Corporation has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

In order to determine OTTI for purchased beneficial interests, the Corporation compares the present value of the remaining cash flows as estimated at the preceding evaluation date to the current expected remaining cash flows. OTTI is deemed to have occurred if there has been an adverse change in the remaining expected future cash flows.

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

As of September 30, 2011, the majority of the Corporation's unrealized losses in the investment securities portfolio related to two pooled trust preferred securities. The decline in fair value on these securities is primarily attributable to the financial crisis and resulting credit deterioration and financial condition of the underlying issuers, all of which are financial institutions. This deterioration may affect the future receipt of both principal and interest payments on these securities. This fact combined with the current illiquidity in the market makes it unlikely that the Corporation would be able to recover its investment in these securities if the securities were sold at this time. One of these securities has been previously written down through the income statement to an amount considered to be immaterial to the financial statements. Therefore management is no longer analyzing this security for further impairment.

Our analysis of these investments includes $629 thousand book value of a collateralized debt obligation ("CDO") consisting is a pooled trust preferred security. This security was rated high quality at inception, but at September 30, 2011 Moody's rated this security as Caa3, which is defined as substantial risk of default. The Corporation uses the OTTI evaluation model to compare the present value of expected cash flows to the previous estimate to determine if there are adverse changes in cash flows during the quarter. The OTTI model considers the structure and term of the CDO and the financial condition of the underlying issuers. Specifically, the model details interest rates, principal balances of note classes and underlying issuers, the timing and amount of interest and principal payments of the underlying issuers, and the allocation of the payments to the note classes. The current estimate of expected cash flows is based on the most recent trustee reports and any other relevant market information including announcements of interest payment deferrals or defaults of underlying trust preferred securities.

Assumptions used in the model include expected future default rates and prepayments. We assume no recoveries on defaults and treat all interest payment deferrals as defaults.

In determining the amount of "currently performing" collateral for the purposes of modeling the expected future cash flows, management analyzed the default and deferral history over the past 3 years. This review indicated significant increases in the number and amount of defaults and deferrals by the issuers. Additionally, management has noted the correlation between the rising levels of non-performing loans as a percent of tangible equity plus loan loss reserves by those issuers that have defaulted and/or deferred interest payments. Therefore management has used this ratio as a primary indicator to project the levels of future defaults for modeling purposes. Management recognizes the potential of defaults and deferrals to continue over the next 12 to 24 months. The operating environment remains difficult for community and regional banks in many parts of the country, which could lead to higher default and deferral levels. Seventy-four depository institutions were closed by regulators during the first nine months of 2011.

The following table provides detailed information related to the pooled trust preferred security analyzed at September 30, 2011:

Description	Actual Deferrals as % of Outstanding Collateral	Actual Defaults as % of Original Collateral	Excess Subordination as % of Performing Collateral	Expected Additional Defaults as % of Performing Collateral
TPREF Funding II, Ltd. (Class B)	17.90%	16.06%	-44.27%	16.14%

In the table above, "Excess Subordination as % of Performing Collateral" was calculated by dividing the difference between the total face value of performing collateral less the face value of all outstanding note balances not subordinate to our investment, by the total face value of performing collateral. This ratio measures the extent to which there may be tranches within a pooled trust preferred structure available to absorb credit losses before the Corporation's security would be impacted. As mentioned earlier, the levels of defaults and deferrals in this pool has increased significantly in recent months, which have resulted in a significant reduction in the amount of performing collateral. As a result, the negative Excess Subordination as a % of Performing Collateral percentages shown above indicate there is no support from subordinate tranches available to absorb losses before the Corporation's security would be impacted. A negative ratio is not the only factor to consider when determining if OTTI should be recorded. Other factors affect the timing and amount of cash flows available for payments to investors such as the excess interest paid by the issuers, as issuers typically pay higher rates of interest than are paid out to investors.

Upon completion of the September 30, 2011 analysis, our model indicated an additional other-than-temporary impairment of $67 thousand on the TPREF Funding II security. This security remained classified as available for sale and represented $352 thousand of the unrealized losses reported at September 30, 2011. Payments continue to be made as agreed on the TPREF Funding II security.

When the analysis was conducted at September 30, 2011, the present value of expected future cash flows using a discount rate equal to the yield in effect at the time of purchase was compared to the previous quarters' analysis. This analysis indicated a further decline in value attributed to credit related factors stemming from further deterioration in the underlying collateral payment streams. Additionally, to estimate fair value the present value of the expected future cash flows was calculated using a current estimated discount rate that a willing market participant might use to value the security based on current market conditions and interest rates. This comparison indicated a slight decrease in value during the quarter, based on factors other than credit, which resulted in a loss reported in other comprehensive income. Changes in credit quality may or may not correlate to changes in the overall fair value of the impaired securities as the change in credit quality is only one component in assessing the overall fair value of the impaired securities. Therefore, the recognition of additional credit related OTTI could result in a gain reported in other comprehensive income. Total other-than-temporary impairment recognized in accumulated other comprehensive income was $220,459 and $265,018 for securities available for sale at September 30, 2011 and September 30, 2010, respectively.

The table below presents a roll forward of the cumulative credit losses recognized in earnings for the three and nine-month periods ending September 30, 2011 and 2010:

	2011	2010
Beginning balance, January 1,	$ 3,438,673	$ 3,045,668
Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized	-	-
Additions/Subtractions:		
Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-
Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	67,400	393,005
Ending balance, September 30,	$ 3,506,073	$ 3,438,673
Beginning balance, July 1,	$ 3,438,673	$ 3,382,293
	-	-

Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized		
Additions/Subtractions:		
Amounts realized for securities sold during the period	-	-
Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis	-	-
Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security	-	-
Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized	67,400	56,380
Ending balance, September 30,	$ 3,506,073	$ 3,438,673

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9. Loans and Allowance for Loan Losses

The composition of the loan portfolio is summarized as follows:

	September 30, 2011	December 31, 2010
Commercial, financial and agricultural	$ 147,815,433	$ 114,697,440
Commercial mortgages	250,030,218	133,070,484
Residential mortgages	194,260,610	173,467,806
Indirect consumer loans	96,093,955	98,940,854
Consumer loans	100,258,360	93,507,785
	$ 788,458,576	$ 613,684,369

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

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

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

Risk Characteristics

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

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

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

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

No allowance for loan losses was recorded as of September 30, 2011 for loans acquired as part of the FOFC merger. These loans were recorded at fair value at the time of the acquisition.

Activity in the allowance for loan losses by portfolio segment was as follows:

Allowance for loan losses	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
	Nine Months Ended September 30, 2011					
Beginning balance:	$ 2,118,299	$ 2,575,058	$ 1,301,780	$ 2,727,022	$ 775,972	$ 9,498,131
Charge Offs:	(593,995)	(3,764)	(39,312)	(542,621)	-	(1,179,692)
Recoveries:	314,797	33,304	30,324	146,726	-	525,151
Net charge offs	(279,198)	29,540	(8,988)	(395,895)	-	(654,541)
Provision	1,444,245	(69,375)	(61,068)	(184,348)	(296,121)	833,333
Ending balance	$ 3,283,346	$ 2,535,223	$ 1,231,724	$ 2,146,779	$ 479,851	$ 9,676,923

Allowance for loan losses	Commercial, Financial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Unallocated	Total
	Three Months Ended September 30, 2011					
Beginning balance:	$ 3,081,433	$ 2,612,655	$ 1,246,880	$ 2,297,459	$ 517,245	$ 9,755,672
Charge Offs:	(590,992)	-	(39,312)	(201,966)	-	(832,270)
Recoveries:	109,391	7,201	-	53,596	-	170,188
Net charge offs	(481,601)	7,201	(39,312)	(148,370)	-	(662,082)
Provision	683,514	(84,633)	24,156	(2,310)	(37,394)	583,333
Ending balance	$ 3,283,346	$ 2,535,223	$ 1,231,724	$ 2,146,779	$ 479,851	$ 9,676,923

	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
Beginning balance:	$ 10,447,291	$ 9,967,223
Charge offs:	(1,298,599)	(1,883,840