PENNS WOODS BANCORP INC
Form 10-K/A
August 25, 2005

FORM 10-K/A

Amendment No. 2

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

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

For the fiscal year ended December 31, 2004

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
(Address of principal executive offices)

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
None	**None**

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

Common Stock, par value $10 per share
(Title of Class)

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 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 an accelerated filer as of defined in Rule 12b-2 of the Act. Yes ý No o

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

State the aggregate market value of the voting stock held by non-affiliates of the registrant **$135,611,421 at June 30, 2004.**

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 7, 2005
Common Stock, $10 Par Value	**3,321,637 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 27, 2005 are incorporated by reference in Part III hereof.

EXPLANATORY NOTE

Penns Woods Bancorp, Inc. (the Company) is filing this Amendment No. 2 on Form 10-K/A to amend the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004, which was filed on March 15, 2005, as amended by Amendment No. 1 on Form 10-K/A, which was filed on May 10, 2005. The original Annual Report on Form 10-K inadvertently omitted the conformed signature of the Company s independent registered public accounting firm from its report, dated February 11, 2005, included in Part II, Item 8, Financial Statements and Supplementary Data. Pursuant to SEC Rule 12b-15, the Company is filing a revised Item 8, in its entirety. The only change to Item 8 as revised by this Amendment No. 2 on Form 10-K/A from Item 8 included in the original Annual Report on Form 10-K filed on March 15, 2005 is the addition of the conformed signature of the Company s independent registered public accounting firm to its audit report, dated February 11, 2005.

This amended Annual Report on Form 10-K/A has not been updated except as required to reflect the effects of the foregoing correction. In order to preserve the nature and character of the disclosures set forth in such items as originally filed, no attempt has been made in this amendment to modify or update the disclosures in the original Annul Report on Form 10-K, except for the foregoing correction. As a result, this amended Annual Report on Form 10-K/A has not been updated for events subsequent to the date of the original filing, and all information contained in this amended Annual Report on Form 10-K/A and the original Annual Report on Form 10-K is subject to updating and supplementing as provided in the periodic reports that the Company has filed and/or will file with the SEC after the original filing date of the Annual Report on Form 10-K.

Pursuant to SEC Rule 12b-15, in connection with this Amendment No. 2 on Form 10-K/A, the Company is filing updated Exhibits 31(v), 31(vi), 32(iii) and 32(iv).

PART II

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 consolidated balance sheet of Penns Woods Bancorp, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in stockholders equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 financial position of Penns Woods Bancorp, Inc. and subsidiaries as of December 31, 2004 and 2003, and the consolidated results of their operations and cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

/s/ S.R. Snodgrass, A.C.
Wexford, Pennsylvania
February 11, 2005

Penns Woods Bancorp, Inc.

Consolidated Balance Sheet

(In Thousands, Except Per Share Data)	**DECEMBER 31, 2004**		**2003**	
ASSETS:				
Noninterest-bearing balances in other financial institutions	$	12,602	$	10,196
Interest-bearing deposits in other financial institutions		24		34
Total cash and cash equivalents		12,626		10,230
Investment securities, available for sale, at fair value		177,957		210,611
Investment securities held to maturity (fair value of $561 and $701)		558		686
Loans held for sale		4,624		4,803
Loans, net of unearned discount of $1,096 and $940		324,505		275,828
Less:Allowance for loan losses		3,338		3,069
Loans, net		321,167		272,759
Premises and equipment, net		4,882		4,625
Accrued interest receivable		2,246		2,242
Bank-owned life insurance		10,976		8,908
Goodwill		3,032		3,032
Other assets		8,635		9,485
TOTAL ASSETS	$	546,703	$	527,381
LIABILITIES:				
Interest-bearing deposits	$	282,786	$	269,443
Noninterest-bearing deposits		74,050		64,875
TOTAL DEPOSITS		356,836		334,318
Short-term borrowings		36,475		47,265
Long-term borrowings, Federal Home Loan Bank		75,878		70,878
Accrued interest payable		850		836
Other liabilities		3,499		4,315
TOTAL LIABILITIES		473,538		457,612
SHAREHOLDERS EQUITY:				
Common stock, par value $10; 10,000,000 shares authorized 3,331,837 and 3,326,560 shares issued		33,318		33,265
Additional paid-in capital		17,700		17,559
Retained earnings		18,262		13,022
Accumulated other comprehensive income		4,331		6,132
Treasury stock, at cost (10,310 and 5,000 shares)		(446)		(209)
TOTAL SHAREHOLDERS EQUITY		73,165		69,769
TOTAL	$	546,703	$	527,381

See Accompanying Notes to the Consolidated Financial Statements.

Penns Woods Bancorp, Inc.

Consolidated Statement of Income

(In Thousands, Except Per Share Data)	YEAR ENDED DECEMBER 31, 2004	2003	2002
INTEREST AND DIVIDEND INCOME:			
Loans including fees	$ 21,363	$ 19,963	$ 20,911
Investment Securities:			
Taxable	7,769	6,550	4,999
Tax-exempt	1,707	2,608	3,252
Other dividend and interest income	108	111	140
TOTAL INTEREST AND DIVIDEND INCOME	30,947	29,232	29,302
INTEREST EXPENSE:			
Deposits	4,775	5,656	7,857
Short-term borrowings	539	428	501
Long-term borrowings	3,454	3,181	2,488
TOTAL INTEREST EXPENSE	8,768	9,265	10,846
NET INTEREST INCOME	22,179	19,967	18,456
PROVISION FOR LOAN LOSSES	465	255	365
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	21,714	19,712	18,091
NON-INTEREST INCOME:			
Service charges	1,983	1,917	1,833
Securities gains, net	2,176	3,479	35
Bank-owned life insurance	294	404	416
Insurance commissions	2,282	1,598	1,807
Other income	1,214	1,056	1,164
TOTAL NON-INTEREST INCOME	7,949	8,454	5,255
NON-INTEREST EXPENSES:			
Salaries and employee benefits	7,937	7,262	6,944
Occupancy expense, net	959	877	831
Furniture and equipment expense	1,016	999	837
Advertising expense	344	388	372
Pennsylvania shares tax expense	508	455	411
Other expenses	3,553	3,308	2,818
TOTAL NON-INTEREST EXPENSES	14,317	13,289	12,213
INCOME BEFORE INCOME TAX PROVISION	15,346	14,877	11,133
INCOME TAX PROVISION	4,263	3,703	2,247
NET INCOME	$ 11,083	$ 11,174	$ 8,886
EARNINGS PER SHARE BASIC	$ 3.33	$ 3.35	$ 2.66
EARNINGS PER SHARE DILUTED	$ 3.33	$ 3.35	$ 2.66
WEIGHTED AVERAGE SHARES OUTSTANDING-BASIC	$ 3,325,007	$ 3,330,585	$ 3,336,312
WEIGHTED AVERAGE SHARES OUTSTANDING-DILUTED	$ 3,328,627	$ 3,333,798	$ 3,339,249

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	AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TREASURY STOCK	TOTAL SHAREHOLDERS EQUITY
Balance, December 31, 2001	3,131,644	$ 31,316	$ 18,230	$ 6,987	$ 1,729	$ (3,010)	$ 55,252
Comprehensive Income:							
Net income				8,886			8,886
Unrealized gain on available for sale securities, net of reclassification adjustments and tax of $1,760					3,416		3,416
Total comprehensive income							12,302
Dividends declared, ($1.24 per share)				(4,124)			(4,124)
Stock options exercised	5,188	52	61				113
Purchase of treasury stock (13,449 shares)						(401)	(401)
Balance, December 31, 2002	3,136,832	31,368	18,291	11,749	5,145	(3,411)	63,142
Stock split effected in the form of a 10% dividend	187,143	1,871	(793)	(4,900)		3,822	
Comprehensive Income:							
Net income				11,174			11,174
Unrealized gain on available for sale securities, net of reclassification adjustments and tax of $508					987		987
Total comprehensive income							12,161
Dividends declared, ($1.49 per share)				(5,001)			(5,001)
Stock options exercised	2,585	26	61				87
Purchase of treasury stock (14,787 shares)						(620)	(620)
Balance, December 31, 2003	3,326,560	33,265	17,559	13,022	6,132	(209)	69,769
Comprehensive Income:							
Net income				11,083			11,083
Unrealized gain on available for sale securities, net of reclassification adjustments and tax of $926					(1,801)		(1,801)
Total comprehensive income							9,282
Dividends declared, ($1.76 per share)				(5,843)			(5,843)
Stock options exercised	5,277	53	141				194
Purchase of treasury stock (5,310 shares)						(237)	(237)
Balance, December 31, 2004	3,331,837	$ 33,318	$ 17,700	$ 18,262	$ 4,331	$ (446)	$ 73,165

Components of comprehensive income (loss):	**2004**	**2003**	**2002**
Change in net unrealized gain (loss) on investment securities available for sale	$ (365)	$ 3,283	$ 3,439
Realized gains included in net income, net of taxes of $740, $1,183 and $12	(1,436)	(2,296)	(23)

Total	$ (1,801)	$ 987	$ 3,416

See Accompanying Notes to the Consolidated Financial Statements

Penns Woods Bancorp, Inc.

Consolidated Statement of Cash Flows

(In Thousands)	YEAR ENDED DECEMBER 31, 2004	2003	2002
OPERATING ACTIVITIES:			
Net income	$ 11,083	$ 11,174	$ 8,886
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	585	631	526
Provision for loan losses	465	255	365
Accretion and amortization of investment security discounts and premiums	(132)	(194)	(906)
Securities gains, net	(2,176)	(3,479)	(35)
Originations of loans held for sale	(34,398)	(15,983)	(16,597)
Proceeds of loans held for sale	34,577	13,831	17,939
Earnings on bank-owned life insurance	(294)	(404)	(416)
Other, net	482	606	(1,190)
Net cash provided by operating activities	10,192	6,437	8,572
INVESTING ACTIVITIES:			
Investment securities available for sale:			
Proceeds from sales	162,796	82,489	79,022
Proceeds from calls and maturities	28,732	48,046	13,047
Purchases	(159,295)	(159,363)	(130,328)
Investment securities held to maturity:			
Proceeds from calls and maturities	142	520	137
Purchases	(14)	(24)	(41)
Net increase in loans	(49,002)	(18,390)	(6,800)
Acquisition of bank premises and equipment	(842)	(400)	(992)
Proceeds from the sale of foreclosed assets	237	341	344
Purchase of bank-owned life insurance	(1,774)		
Proceeds from redemption of regulatory stock	3,322	1,507	1,262
Purchases of regulatory stock	(2,940)	(4,402)	(2,080)
Net cash used for investing activities	(18,638)	(49,676)	(46,429)
FINANCING ACTIVITIES:			
Net increase (decrease) in interest-bearing deposits	13,343	(3,344)	22,914
Net increase (decrease) in noninterest-bearing deposits	9,175	(2,186)	11,784
Net (decrease) increase in short-term borrowings	(10,790)	33,702	(5,542)
Proceeds from other borrowings	5,000	20,000	10,000
Repayment of other borrowings		(900)	
Dividends paid	(5,843)	(5,001)	(4,124)
Stock options exercised	194	87	113
Purchase of treasury stock	(237)	(620)	(401)
Net cash provided by financing activities	10,842	41,738	34,744
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,396	(1,501)	(3,113)
CASH AND CASH EQUIVALENTS, BEGINNING	10,230	11,731	14,844
CASH AND CASH EQUIVALENTS, ENDING	$ 12,626	$ 10,230	$ 11,731
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Interest paid	$ 8,754	$ 9,521	$ 10.944
Income taxes paid	$ 4,350	$ 3,500	$ 3,394

Transfer of loans to foreclosed real estate	$	129	$	173	$	254

See Accompanying Notes to the Consolidated Financial Statements

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 (the Bank), 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 the Bank (collectively, the Company). All significant intercompany balances and transactions have been eliminated.

Nature of Business

The Bank engages 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 loans and various types of time and demand deposits including, but not limited to, checking accounts, savings accounts, clubs, 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 bank to individuals, partnerships, non-profit organizations and corporations through its eleven offices located in Clinton, Lycoming, and Centre Counties, Pennsylvania and a Financial Center located in State College, Pennsylvania.

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

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

The M Group engages in securities brokerage and insurance activities.

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

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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, deferred tax assets and liabilities, and the valuation of real estate acquired through, or in lieu of, foreclosure on settlement of debt.

Cash and Cash Equivalents

Cash equivalents include cash on hand and in banks, interest-earning deposits and federal funds sold. Interest-earning deposits mature within one year and are carried at cost. Net cash flows are reported for loan and deposit transactions.

Investment Securities

Investment securities are classified as available for sale or held to maturity.

Securities held to maturity include bonds, notes, and debentures for which the Company has the positive intent and ability to hold to maturity and are reported at amortized cost.

Available for sale securities consist of bonds, notes, debentures, and certain equity securities not classified as trading securities nor as held to maturity securities. Unrealized holding gains and losses, net of tax, on available for sale securities are reported as a net amount as a separate component of shareholders equity until realized.

Gains and losses on the sale of equity securities are determined using the average cost method, while all other investment securities use the specific cost method.

All investment securities, regardless of classification, are monitored and tested for impairment. An investment security is considered to be impaired when the unrealized loss is considered to be other than temporary. When this occurs, the investment is written down to the current fair market value with the write-downs being reflected as a realized loss.

Premiums and discounts on all securities are recognized in interest income using the interest method over the period to maturity.

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.

Loans

Loans are stated at the principal amount outstanding, net of unearned discount, 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 collectibility 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.

Loan origination and commitment fees as well as certain direct loan origination costs are being deferred and the net amount amortized as an adjustment to the related loan s yield. These amounts are being amortized 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 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, 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.

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, 2004, 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, 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 income. Additionally, as an integral part of the examination process, bank regulatory agencies periodically review the Bank s loan loss allowance. The banking agencies 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.

Impaired loans are commercial and commercial real estate loans for which it is probable the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement. The Company individually evaluates such loans for impairment and does 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 Company may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectibility, 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 impaired 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.

Loans Held for Sale

In general, fixed rate residential mortgage loans originated by the Bank are held for sale and are carried at the aggregate lower of cost or market. Such loans sold are not serviced by the Bank.

Foreclosed Assets Held for Sale

Foreclosed assets held for sale are carried at the lower of cost or fair value less estimated costs to sell. 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 writedowns are charged against operating expenses. Operating expenses of such properties, net of related income, and gains and losses on their disposition are included in other expenses.

Foreclosed assets held for sale totaled $40,000 and $132,000 at December 2004 and 2003, respectively.

Bank Premises and Equipment

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 seven years for furniture, fixtures and equipment and thirty-one and a half 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, and is the sole beneficiary on those policies. 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 non-interest income.

Goodwill

The company accounts for goodwill in accordance with Statement of Financial Accounting Standards (FAS) No. 142, Goodwill and Other Intangible Assets. This statement, among other things, requires a two-step process for testing the impairment of goodwill on at least an annual basis. This approach could cause more volatility in the Company s reported net income because impairment losses, if any, could occur irregularly and in varying amounts. The Company performs an annual

8

impairment analysis of goodwill. Based on the fair value of the reporting unit, estimated using the expected present value of future cash flows, no impairment of goodwill was recognized in 2004 and 2003.

Advertising Costs

Advertising costs are generally expensed as incurred.

Income Taxes

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.

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 the Bank. 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 and an elective contribution are made annually at the discretion of the Board of Directors.

Stock Options

The Company maintains a stock option plan for the directors, officers and employees. When the exercise price of the Company s stock options is greater than or equal to the market price of the underlying stock on the date of the grant, no compensation expense is recognized in the Company s financial statements. Pro forma net income and earnings per share are presented to reflect the impact of the stock option plan assuming compensation expense had been recognized based on the fair value of the stock options granted under the plan.

The Company applies Accounting Principles Board Opinion No. 25 and related interpretations in accounting for these options. Accordingly, compensation expense is recognized on the grant date, in the amount equivalent to the intrinsic value of the options (stock price less exercise price, at measurement date).

Had compensation costs for these options been determined based on the fair values at the grant dates for awards consistent with the method of FAS No. 123, there would be no effect on the Company s net income and earnings per share for 2004, 2003, and 2002.

Comprehensive Income

The Company is required to present comprehensive income in a full set of general-purpose financial statements for all periods presented. Other comprehensive income is comprised exclusively of unrealized holding gains (losses) on the available for sale securities portfolio.

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 December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (FAS) No. 123 (Revised 2004), Share-Based Payment. The Statement requires that compensation cost relating to share-based payment transactions be recognized in financial statements and that this cost be measured based on the fair value of the equity or liability instruments issued. FAS No. 123 (Revised 2004) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Company will adopt FAS No. 123 (Revised 2004) on July 1, 2005 and is currently evaluating the impact the adoption of the standard will have on the Company s results of operations.

In October 2003, the American Institute of Certified Public Accountants issued SOP 03-3, Accounting for Loans or Certain Debt Securities Acquired in a Transfer. SOP 03-3 applies to a loan that is acquired where it is probable, at acquisition, that a transferee will be unable to collect all contractually required payments receivable. SOP 03-3 requires the recognition, as accretable yield, the excess of all cash flows expected at acquisition over the investor s initial investment in the loan as interest income on a level-yield basis over the life of the loan. The amount by which the loan s contractually required payments exceed the amount of its expected cash flows at acquisition may not be recognized as an adjustment to yield, a loss accrual or a valuation allowance for credit risk. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 31, 2004. Early adoption is permitted. The adoption of SOP 03-3 is not expected to have a material impact on the consolidated financial statements.

NOTE 2 - PER SHARE DATA

There are no convertible securities, which would affect the numerator 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.

	2004	**2003**	**2002**
Weighted average common shares outstanding	3,327,780	3,430,302	3,445,477
Weighted average treasury stock shares	(2,773)	(99,717)	(109,165)
Weighted average common shares and common stock equivalents used to calculate basic earnings per share	3,325,007	3,330,585	3,336,312
Additional common stock equivalents (stock options) used to calculate diluted earnings per share	3,620	3,213	2,937
Weighted average common shares and common stock equivalents used to calculate diluted earnings per share	3,328,627	3,333,798	3,339,249

Options to purchase 8,713 shares of common stock at a price of $48.35 were outstanding during 2004, 10,890 shares of common stock at a price of $48.35 were outstanding during 2003 and 22,385 shares of common stock at prices from $38.18 to $48.35 were outstanding during 2002, but were not included in the computation of diluted earnings per share as they were anti-dilutive due to the strike price being greater than the market price as of the end of the fiscal year.

NOTE 3 INVESTMENT SECURITIES

The amortized cost of investment securities and their approximate fair values are as follows:

	2004			
(In Thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available for Sale (AFS)				
U.S. Government and agency securities	$ 104,248	$ 207	$ (430)	$ 104,025
State and political securities	46,829	766	(527)	47,068
Other debt securities	1,302	47	(7)	1,342
Total debt securities	152,379	1,020	(964)	152,435
Equity securities	19,015	6,579	(72)	25,522
Total Investment Securities AFS	$ 171,394	$ 7,599	$ (1,036)	$ 177,957
Held to Maturity (HTM)				
U.S. Government and agency securities	$ 32	$	$	$ 32
State and political securities	248	3		251
Other debt securities	278			278
Total Investment Securities HTM	$ 558	$ 3	$	$ 561

	2003			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Available for Sale (AFS)				
U.S. Government and agency securities	$ 150,218	$ 626	$ (1,015)	$ 149,829
State and political securities	31,364	2,510	(22)	33,852
Other debt securities	1,581	75	(4)	1,652
Total debt securities	183,163	3,211	(1,041)	185,333
Equity securities	18,158	7,146	(26)	25,278
Total Investment Securities AFS	$ 201,321	$ 10,357	$ (1,067)	$ 210,611
Held to Maturity (HTM)				
U.S. Government and agency securities	$ 75	$	$ (1)	$ 74
State and political securities	347	16		363
Other debt securities	264			264
Total Investment Securities HTM	$ 686	$ 16	$ (1)	$ 701

The following table shows 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, 2004.

	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
U.S. Government and agency Securities	$ 51,636	$ 226	$ 28,598	$ 204	$ 80,234	$ 430
State and political securities	17,339	527			17,339	527
Other debt securities	142	3	146	4	288	7
Total debt securities	69,117	756	28,744	208	97,861	964
Equity securities	1,187	64	298	8	1,485	72
Total	$ 70,304	$ 820	$ 29,042	$ 216	$ 99,346	$ 1,036

The policy of the Company is to recognize other than temporary impairment of equity securities where the fair value has been significantly below cost for one year. For fixed maturity investments with unrealized losses due to interest rates where the Company has the positive intent and ability to hold the investment for a period of time sufficient to allow a market recovery, declines in value below cost are not assumed to be other than temporary. The Company reviews its position quarterly and has asserted that at December 31, 2004, the declines outlined in the above table represent temporary declines and the Company does have the intent and ability to hold those securities either to maturity or to allow a market recovery.

The Company has concluded that any impairment of its investment securities portfolio is not other than temporary but is the result of interest rate changes, sector credit rating changes, or company-specific rating 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, 2004, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	HELD TO MATURITY		AVAILABLE FOR SALE	
(In Thousands)	AMORTIZED COST	FAIR VALUE	AMORTIZED COST	FAIR VALUE
Due in one year or less	$ 75	$ 75	$ 1,019	$ 1,024
Due after one year to five years	75	75	3,420	3,473
Due after five years to ten years	376	379	15	16
Due after ten years	32	32	147,925	147,922
	$ 558	$ 561	$ 152,379	$ 152,435

Total gross proceeds from sales of securities available for sale were $162,796,000, $82,489,000, and $79,022,000 for 2004, 2003, and 2002, respectively. The following table represents gross realized gains and gross realized losses on those transactions:

(In Thousands)	2004	2003	2002
Gross realized gains:			
U.S. Government and agency securities	$ 459	$ 254	$ 204
State and political securities	1,191	3,345	2,234
Other debt securities	1	27	6
Equity securities	2,192	1,015	1,605
	$ 3,843	$ 4,641	$ 4,049
Gross realized losses:			
U.S. Government and agency securities	$ 1,623	$ 742	$ 125
State and political securities	23	50	67
Other debt securities		2	
Equity securities	21	368	3,822
	$ 1,667	$ 1,162	$ 4,014

In 2003, the Company recorded an investment security gain of $24,000 resulting from a business combination where the Company received the common stock of the acquirer in a non-monetary exchange. This gain is included in the above table. There were no gains of this nature in 2004.

A charge of $292,000 was recorded in 2003 and $2,083,000 was recorded in 2002 to recognize other than temporary declines in the value of marketable equity securities. These losses are included in the above table.

Investment securities with a carrying value of approximately $71,730,000 and $34,059,000 at December 31, 2004 and 2003, respectively, were pledged to secure certain deposits, security 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 4 - LOANS

Major loan classifications are summarized as follows:

(In Thousands)	CURRENT	PAST DUE 30 TO 90 DAYS	2004 PAST DUE 90 DAYS OR MORE & STILL ACCRUING	NON-ACCRUAL	TOTAL
Commercial and agricultural	$ 29,467	$ 389	$ 82	$ 165	$ 30,103
Real estate mortgage:					
Residential	143,028	3,530	254	649	147,461
Commercial	121,951	1,257		549	123,757
Construction	8,359			6	8,365
Installment loans to individuals	15,495	399	9	12	15,915
	318,300	$ 5,575	$ 345	$ 1,381	325,601
Less: Net deferred loan fees	1,096				1,096
Allowance for loan losses	3,338				3,338
Loans, net	$ 313,866				$ 321,167

	CURRENT	PAST DUE 30 TO 90 DAYS	2003 PAST DUE 90 DAYS OR MORE & STILL ACCRUING	NON-ACCRUAL	TOTAL
Commercial and agricultural	$ 23,105	$ 215	$ 21	$ 182	$ 23,523
Real estate mortgage:					
Residential	144,102	2,625	383	587	147,697
Commercial	82,156	667	15	58	82,896
Construction	7,637	15			7,652
Installment loans to individuals	14,738	252	10		15,000
	271,738	$ 3,774	$ 429	$ 827	276,768
Less: Net deferred loan fees	940				940
Allowance for loan losses	3,069				3,069
Loans, net	$ 267,729				$ 272,759

Loans on which the accrual of interest has been discontinued or reduced amounted to approximately $1,381,000 and $827,000 at December 31, 2004 and 2003, respectively. If interest had been recorded at the original rate on those loans, such income would have approximated $64,000, $55,000, and $24,000 for the years ended December 31, 2004, 2003 and 2002, respectively. Interest income on such loans, which is recorded as received, amounted to approximately $10,000, $7,000, and $17,000, for the years ended December 31, 2004, 2003 and 2002, respectively.

Charges in the allowance for loan losses for the years ended December 31, are as follows:

(In Thousands)	2004	2003	2002
Balance, beginning of year	$ 3,069	$ 2,953	$ 2,927
Provision charged to operations	465	255	365
Loans charged off	(283)	(216)	(402)
Recoveries	87	77	63
Balance, end of year	$ 3,338	$ 3,069	$ 2,953

The Company had no concentration of loans to borrowers engaged in similar businesses or activities which exceed five percent of total assets at December 31, 2004 or December 31, 2003.

The Company grants commercial, industrial, residential, and installment loans to customers throughout north-central Pennsylvania. Although the Company has a diversified loan portfolio at December 31, 2004 and 2003, a substantial portion of its debtors ability to honor their contracts is dependent on the economic conditions within this region.

NOTE 5 - PREMISES AND EQUIPMENT

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

(In Thousands)	2004	2003
Land	$ 566	$ 566
Premises	5,290	4,883
Furniture and equipment	6,756	6,348
Leasehold improvements	894	867
Total	13,506	12,664
Less accumulated depreciation	8,624	8,039
Net	$ 4,882	$ 4,625

Depreciation charges to operations for the years ended 2004, 2003, and 2002 were $585,000, $631,000, and $526,000, respectively.

The Bank has committed to $1,000,000 for the premises and equipment of a new branch in State College, PA.

NOTE 6 - GOODWILL

As of December 31, 2004, 2003, and 2002 goodwill had a gross carrying value of $3,308,000 and accumulated amortization of $276,000 resulting in a net carrying amount of $3,032,000.

The gross carrying amount of goodwill is tested for impairment in the third quarter of each fiscal year. Based on fair value of the reporting unit, estimated using the expected present value of future cash flows, no goodwill impairment loss was recognized in the current year.

NOTE 7 - DEPOSITS

Time deposits of $100,000 or more totaled approximately $30,212,000 on December 31, 2004 and $27,386,000 on December 31, 2003. Interest expense related to such deposits was approximately $818,000, $829,000, and $1,098,000, for the years ended December 31, 2004, 2003 and 2002, respectively.

Maturities on time deposits of $100,000 or more are as follows:

(In Thousands)		**2004**
Three months or less	$	6,869
Three months to six months		5,316
Six months to twelve months		8,807
Over twelve months		9,220
Total	$	30,212

Total time deposits at December 31, 2004 mature as follows:

(In Thousands)		2004
2005	$	81,340
2006		22,237
2007		13,998
2008		5,811
2009		652
Thereafter		1,353
Total	$	125,391

Total deposits at December 31 are as follows:

(In Thousands)		2004		2003
Demand deposits	$	74,050	$	64,875
Interest-bearing demand deposits		87,588		77,245
Saviings deposits		69,807		67,298
Time deposits		125,391		124,900
Total deposits	$	356,836	$	334,318

NOTE 8 - SHORT-TERM BORROWINGS

Short-term borrowings consist of securities sold under agreements to repurchase and FHLB advances which generally represent overnight or less than 30-day borrowings. The outstanding balances and related information for short-term borrowings are summarized as follows:

(In Thousands)		2004		2003
Repurchase Agreements:				
Balance at year end	$	13,845	$	10,225
Maximum amount outstanding at any month end		15,301		15,665
Average balance outstanding during the year		13,317		13,214
Weighted-average interest rate:				
At year end		1.82%		1.91%
Paid during the year		1.77%		2.07%
Open Repo Plus:				
Balance at year end	$	22,630	$	36,140
Maximum amount outstanding at any month end		32,480		36,140
Average balance outstanding during the year		18,336		11,537
Weighted-average interest rate:				
At year end		2.24%		1.06%
Paid during the year		1.64%		1.16%
Short Term FHLB:				
Balance at year end	$		$	900
Maximum amount outstanding at any month end		900		900

Average balance outstanding during the year	204	695
Weighted-average interest rate:		
At year end		1.40%
Paid during the year	1.42%	1.42%

NOTE 9 - OTHER BORROWINGS

The following represents outstanding long-term borrowings by contractual maturities at December 31, 2004 and 2003:

(In Thousands)	2004	2003
Variable rate of 4.49%, maturing in 2007	$ 5,000	$ 5,000
Variable rates between 3.14% and 5.56%, maturing in 2008	29,600	29,600
Variable rate of 5.06%, maturing in 2009	5,000	5,000
Variable rate of 6.65%, maturing in 2010	5,000	5,000
Variable rates of 4.25% and 4.72%, maturing in 2011	10,000	10,000
Variable rate of 3.68%, maturing in 2012	5,000	5,000
Variable rate of 3.74%, maturing in 2013	5,000	5,000
Fixed rate of 2.02%, maturing in 2005	1,400	1,400
Fixed rate of 2.58%, maturing in 2006	1,600	1,600
Fixed rates between 2.67% and 3.13%, maturing in 2007	6,500	1,500
Fixed rate of 6.95%, maturing in 2011	500	500
Fixed rate of 5.87%, maturing in 2013	528	528
Fixed rate of 6.92%, maturing in 2015	750	750
Total	$ 75,878	$ 70,878

The terms of the convertible borrowings allow the Federal Home Loan Bank (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.

The Bank maintains a credit arrangement, which includes a revolving line of credit with the FHLB. Under this credit arrangement, the Bank has a remaining borrowing capacity of approximately $145 million at December 31, 2004, is subject to annual renewal, and typically incurs no service charges. Under terms of a blanket agreement, collateral for the FHLB borrowings must be secured by certain qualifying assets of the Bank which consist principally of first mortgage loans.

NOTE 10 - INCOME TAXES

The following temporary differences gave rise to the net deferred tax liability at December 31, 2004 and 2003:

(In Thousands)	2004	2003
Deferred tax asset:		
Allowance for loan losses	$ 841	$ 716
Deferred compensation	353	346
Contingencies	24	22
Pension	515	429
Loan fees and costs	368	320
Investment securities allowance	98	119
Other	15	
Total	2,214	1,952

Deferred tax liability:				
Bond accretion		21		28
Depreciation		205		260
Amortization		225		150
Unrealized gains on available for sale securities		2,231		3,159
Total		2,682		3,597
Deferred tax liability, net	$	(468)	$	(1,645)

17

No valuation allowance was established at December 31, 2004 and 2003, in the view of the Company s ability to carry back taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company s earning potential.

The provision for income taxes is comprised of the following for the years ended December 31:

(In Thousands)	2004	2003	2002
Currently payable	$ 4,512	$ 3,666	$ 2,363
Deferred (benfit) expense	(249)	37	(116)
Total provision	$ 4,263	$ 3,703	$ 2,247

The effective federal income tax rate for the years ended December 31, 2004, 2003, and 2002 was 27.8%, 24.9% and 20.2%, respectively. A reconciliation between the expected income tax and the effective income tax rate on income before income tax provision follows:

	2004		2003		2002	
	AMOUNT	%	AMOUNT	%	AMOUNT	%
Provision at expected rate	$ 5,218	34.0%	$ 5,058	34.0%	$ 3,785	34.0%
Decrease in tax resulting from:						
Tax-exempt income	(632)	(4.1)	(964)	(6.4)	(1,367)	(12.3)
Other, net	(323)	(2.1)	(391)	(2.7)	(171)	(1.5)
Effective income tax and rates	$ 4,263	27.8%	$ 3,703	24.9%	$ 2,247	20.2%

NOTE 11 - EMPLOYEE BENEFIT PLANS

DEFINED BENEFIT PENSION PLAN

The Company has a noncontributory defined benefit pension plan (the Plan) for all employees hired prior to January 1, 2004, meeting certain age and length of service requirements. 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.

The following tables show the funded status and components of net periodic benefit cost from this defined benefit plan:

		2004		2003
Change in benefit obligation				
Benefit obligation at beginning of year	$	7,145	$	6,473
Service cost		447		443
Interest cost		398		384
Actuarial (gain) loss		(225)		43
Benefits paid		(216)		(198)
Benefit obligation at end of year	$	7,549	$	7,145
Change in plan assets				
Fair value of plan assets at beginning of year	$	4,042	$	3,131
Actual return on plan assets		394		620
Employer contribution		347		506
Benefits paid		(216)		(198)
Expenses paid		(18)		(17)
Fair value of plan assets at end of year		4,549		4,042
Funded status		(3,000)		(3,103)
Unrecognized net actuarial loss		1,275		1,609
Unrecognized prior service cost		229		255
Unrecognized tranisition asset		(19)		(22)
Net Accrued Benefit Cost Recognized	$	(1,515)	$	(1,261)

The accumulated benefit obligation for the defined benefit pension plan was $5,606,000, and $4,913,000 at December 31, 2004 and 2003, respectively. Amounts recognized in the Statement of Income consist of:

(In Thousands)		2004		2003		2002
Service cost	$	447	$	443	$	381
Interest cost		398		384		342
Expected return on plan assets		(376)		(256)		(246)
Amortization of transition asset		(3)		(3)		(3)
Amortization of prior service cost		26		26		26
Recognized net actuarial gain		109		83		19
Net periodic benefit cost	$	601	$	677	$	519

The plan was amended, effective January 1, 2004, to cease eligibility for employees with a hire date of January 1, 2004 or later. Employees with a hire date of January 1, 2004 or later are eligible to receive, after meeting certain age and length of service requirements, an annual discretionary pension contribution from the Bank equal to a percentage of an employee s base compensation. The dollars will be placed in a separate account within the 401(k) plan with a vesting requirement.

The following information relates to the Plan s projected obligation, accumulated benefit obligation, and plan assets at December 31:

(In Thousands)		2004		2003
Projected benefit obligation	$	7,549	$	7,145
Accumulative benefit obligation		5,606		4,913
Fair value of plan assets		4,549		4,042

Assumptions

Weighted-average assumptions used to determine benefit obligations at December 31:

	2004	2003	2002
Discount rate	5.75%	6.00%	6.00%
Rate of compensation increase	4.75%	5.00%	5.00%

Weighted-average assumptions used to determine net periodic cost for years ended December 31:

	2004	2003	2002
Discount rate	6.00%	6.00%	6.50%
Expected long-term return on plan assets	8.00%	8.00%	8.00%
Rate of compensation increase	5.00%	5.00%	5.00%

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 Company s pension plan weighted-average asset allocations at December 31 by asset category are as follows:

Asset Category	2004	2003
Cash	0.3%	0.6%
Fixed Income securities	37.9%	38.7%
Equity	61.8%	60.7%
Total	100.0%	100.0%

The investment objective for the defined pension 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. The portfolio s target exposure to equities is 60%, primarily invested in mid and large capitalization domestic equities. Exposure to small capitalization and international stocks may be allowed.

Asset allocation favors equities, with target allocation of approximately 60% equity securities, 37.5% fixed income securities 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.

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.

The following benefit payments, which reflect expected future cost, are expected to be paid during the years ended December 31:

Estimated future benefit payments:

(In Thousands)		
2005	$	181
2006		192
2007		235
2008		272
2009		277
20010 - 2014		2,242
	$	3,399

The company expects to contribute $575,000 to its Pension Plan in 2005.

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 to be determined by the Company. Participants are at all times fully vested in their contributions and vest over a period of five years in the employer contribution. Contribution expense was approximately $83,000, $75,000, and $80,000 for the years ended December 31, 2004, 2003, and 2002, respectively.

DEFERRED COMPENSATION PLAN

Certain directors have entered into deferred compensation agreements with the Corporation pursuant to which all or a specified portion of their directors fees are deferred until their retirement or termination of service. Interest on amounts credited to the account balance for each director accrues at an amount equal to one half of the Corporation s return on equity for the prior year. To fund benefits under the deferred compensation plan, the Company has acquired corporate-owned life insurance policies on the lives of the participating directors for which insurance benefits are payable to the Company. The total expense charged to other expenses was $73,000, $104,000, and $98,000 for the years ended December 31, 2004, 2003 and 2002, respectively. Benefits paid under the plan were approximately $127,000 in 2004, $132,000 in 2003 and $51,000 in 2002.

NOTE 12 - STOCK OPTIONS

Prior to 1998, the Company granted a select group of its officers options to purchase shares of its common stock. These options, which are immediately exercisable, expire within three to ten years after having been granted. Also, in 1998, the Company adopted the 1998 Stock Option Plan for key employees and directors. Incentive stock options and nonqualified stock options may be granted to eligible employees of the Bank and nonqualified options may be granted to directors of the Company. In addition, non-employee directors are eligible to receive grants of nonqualified stock options. Incentive nonqualified stock options granted under the 1998 Plan may be exercised not later than ten years after the date of grant. Each option granted under the 1998 Plan shall be exercisable only after the expiration of six months following the date of grant of such options.

A summary of the status of the Company s common stock option plans are presented below:

	2004			2003		
	SHARES		WEIGHTED AVERAGE EXERCISE PRICE	SHARES		WEIGHTED AVERAGE EXERCISE PRICE
Outstanding, beginning of year	30,607	$	39.39	33,385	$	38.69
Granted						
Exercised	(5,277)		36.73	(2,778)		30.93
Forfeited	(9,365)		38.63			
Outstanding, end of year	15,965		40.24	30,607		39.39
Options exercisable at year-end	15,965	$	40.24	30,607	$	39.39

The following table summarizes information about nonqualified and incentive stock options outstanding at December 31, 2004:

EXERCISE PRICE		OUTSTANDING				EXERCISABLE		
		SHARES	AVERAGE LIFE		AVERAGE EXERCISE PRICE	SHARES		AVERAGE EXERCISE PRICE
$	48.35	8,410	4	$	48.35	8,410	$	48.35
$	38.18	1,375	5	$	38.18	1,375	$	38.18
$	29.66	6,180	2	$	29.66	6,180	$	29.66

NOTE 13 - 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:

(In Thousands)		BEGINNING BALANCE		ADDITIONS		PAYMENTS		RESIGNED		ENDING BALANCE
2004	$	7,227	$	5,720	$	1,273	$		$	11,674
2003	$	6,785	$	2,374	$	1,791	$	141	$	7,227

NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES

The following schedule of future minimum rental payments under operating leases with noncancellable terms in excess of one year as of December 31, 2004:

Year Ending December 31,
(In Thousands)

2005	$	348
2006		326
2007		293
2008		194
2009		105
Thereafter		1,837
Total	$	3,103

Total rental expense for all operating leases for the years ended December 31, 2004, 2003 and 2002 were $320,000, $269,000, and $258,000 respectively.

The Company is subject to lawsuits and claims arising out of its business. In the opinion of management, after review and consultation with counsel, any proceedings that may be assessed will not have a material adverse effect on the consolidated financial position of the Company.

NOTE 15 - 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:

(In Thousands)		**2004**		**2003**
Commitments to extend credit	$	42,537	$	47,454
Standby letters of credit	$	1,321	$	258

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 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 16 - CAPITAL REQUIREMENTS

Federal regulations require the Company and the Bank to maintain minimum amounts of capital. Specifically, each is required to maintain certain minimum dollar amounts and ratios of 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, 2004 and 2003, the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well capitalized financial institution, Total risk-based, Tier 1 risk-based and Tier 1 leverage capital ratios must be at least 10%, 6%, and 5%, respectively.

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

The Company s actual capital amounts and ratios are presented in the following table:

	2004		2003	
(In Thousands)	**AMOUNT**	**RATIO**	**AMOUNT**	**RATIO**
Total Capital (to Risk-weighted Assets)				
Actual	$ 72,042	21.8%	$ 66,820	23.0%
For Capital Adequacy Purposes	26,475	8.0	23,225	8.0
To Be Well Capitalized	33,094	10.0	29,031	10.0
Tier 1 Capital (to Risk-weighted Assets)				
Actual	$ 65,776	19.9%	$ 60,547	20.9%
For Capital Adequacy Purposes	13,238	4.0	11,613	4.0
To Be Well Capitalized	19,856	6.0	17,419	6.0
Tier 1 Capital (to Average Assets)				
Actual	$ 65,776	12.1%	$ 60,547	11.6%
For Capital Adequacy Purposes	21,750	4.0	20,922	4.0
To Be Well Capitalized	27,187	5.0	26,153	5.0

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

	2004		2003	
(In Thousands)	**AMOUNT**	**RATIO**	**AMOUNT**	**RATIO**
Total Capital (to Risk-weighted Assets)				
Actual	$ 55,717	17.6%	$ 52,161	18.8%
For Capital Adequacy Purposes	25,311	8.0	22,155	8.0
To Be Well Capitalized	31,639	10.0	27,693	10.0
Tier 1 Capital (to Risk-weighted Assets)				
Actual	$ 51,213	16.2%	$ 47,770	17.3%
For Capital Adequacy Purposes	12,656	4.0	11,077	4.0
To Be Well Capitalized	18,983	6.0	16,616	6.0
Tier 1 Capital (to Average Assets)				
Actual	$ 51,213	9.7%	$ 47,770	9.6%
For Capital Adequacy Purposes	21,039	4.0	19,982	4.0
To Be Well Capitalized	26,299	5.0	24,978	5.0

NOTE 17 - REGULATORY RESTRICTIONS

The Pennsylvania Banking Code restricts the availability of capital funds for payment of dividend by all state-chartered banks to the additional paid in capital of the Bank. Accordingly, at December 31, 2004, the balance in the additional paid in capital account totaling approximately $11,700,000 is unavailable for dividends.

The Bank is subject to regulatory restrictions, which limit its ability to loan funds to Penns Woods Bancorp, Inc. At

December 31, 2004, the regulatory lending limit amounted to approximately $5,502,000.

Cash and Due from Banks

Included in cash and due from banks are reserves required by the district Federal Reserve Bank of $1,197,000 and $1,151,000 at December 31, 2004 and 2003. 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.

NOTE 18 - ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company is required to disclose estimated fair values for its financial instruments. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates 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 value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates 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 estimates.

Estimated fair values have been determined by the Company using historical data and an estimation methodology suitable for each category of financial instruments. The estimated fair value of the Company s investment securities is described in Note 1.

The Company s fair value estimates, 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, this estimated fair value of financial instruments would not represent the full market value of the Company.

The estimated fair values of the Company s financial instruments are as follows at December 31,:

	2004		2003	
(In Thousands)	**CARRYING VALUE**	**FAIR VALUE**	**CARRYING VALUE**	**FAIR VALUE**
Financial assets:				
Cash and due from equivalents	$ 12,626	$ 12,626	$ 10,230	$ 10,230
Investment securities:				

Available for sale	177,957	177,957	210,611	210,611
Held to maturity	558	561	686	701
Loans held for sale	4,624	4,624	4,803	4,803
Loans, net	321,167	331,350	272,759	287,310
Bank-owned life insurance	10,976	10,976	8,908	8,908
Regulatory stock	6,206	6,206	6,588	6,588
Accrued interest receivable	2,246	2,246	2,242	2,242
Financial liabilities:				
Interest-bearing deposits	$ 282,786	$ 263,509	$ 269,443	$ 271,200
Noninterest-bearing deposits	74,050	74,050	64,875	64,875
Short-term borrowings	36,475	36,475	47,265	47,265
Long-term borrowings, FHLB	75,878	77,858	70,878	73,107
Accrued interest payable	850	850	836	836

Cash and Cash Equivalents, Loans Held for Sale, Regulatory Stock, 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 and held to maturity is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

Loans:

Fair values are estimated 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 estimated 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 life insurance policies.

Deposits:

The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings and NOW accounts, and money market and checking accounts, is equal to the amount payable on demand as of December 31, 2004 and 2003. The fair value of certificates of deposit is based on the discounted value of contractual cash flows.

The fair value estimates 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.

Other borrowings:

The fair value of other 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 estimated fair value of off-balance sheet items at December 31, 2004 and 2003, respectively. The contractual amounts of unfunded commitments and letters of credit are presented in Note 15.

NOTE 19 - PARENT COMPANY ONLY FINANCIAL STATEMENTS

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

CONDENSED BALANCE SHEET, DECEMBER 31,

(In Thousands)	**2004**	**2003**
ASSETS		
Cash	$ 453	$ 369
Investment in subsidiaries:		
Bank	56,743	54,133
Nonbank	15,980	15,307
Other assets	104	91
Total Assets	$ 73,280	$ 69,900
LIABILITIES AND SHAREHOLDERS EQUITY		
Other liabilities	$ 115	$ 131
Shareholders equity	73,165	69,769
Total liability and shareholders equity	$ 73,280	$ 69,900

CONDENSED STATEMENT OF INCOME

FOR THE YEARS ENDED DECEMBER 31,

(In Thousands)	**2004**	**2003**	**2002**
Operating income:			
Dividends from subsidiaries	$ 6,440	$ 6,651	$ 4,878
Equity in undistributed net income of subsidiaries	4,833	4,649	4,121
Operating expenses:	(190)	(126)	(113)
Net income	$ 11,083	$ 11,174	$ 8,886

CONDENSED STATEMENT OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31,

(In Thousands)	**2004**	**2003**	**2002**
OPERATING ACTIVITIES			
Net income	$ 11,083	$ 11,174	$ 8,886
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiaries	(4,833)	(4,649)	(4,121)
Other, net	(9)	(64)	(23)
Net cash provided by operating activities	6,241	6,461	4,742
INVESTING ACTIVITIES			
Additional investment in subsidiaries	(271)	(1,039)	
FINANCING ACTIVITIES			
Dividends paid	(5,843)	(5,001)	(4,124)
Proceeds from exercise of stock options	194	87	113
Purchase/retirement of treasury stock	(237)	(620)	(401)
Net cash used for financing activities	(5,886)	(5,534)	(4,412)
NET INCREASE (DECREASE) IN CASH	84	(112)	330
CASH, BEGINNING OF YEAR	369	481	151
CASH, END OF YEAR	$ 453	$ 369	$ 481

NOTE 20 - CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)

(In Thousands, Except Per Share Data)

	FOR THE THREE MONTHS ENDED			
2004	**March 31,**	**June 30,**	**Sept. 30,**	**Dec. 31,**
Interest income	$ 7,327	$ 7,532	$ 7,924	$ 8,164
Interest expense	2,124	2,142	2,229	2,273
Net interest income	5,203	5,390	5,695	5,891
Provision for loan losses	75	75	165	150
Non-interest income	1,492	1,467	1,548	1,266
Securities gains, net	545	583	407	641
Non-interest expenses	3,473	3,453	3,509	3,882
Income before income tax provision	3,692	3,912	3,976	3,766
Income tax provision	1,019	1,108	1,150	986
Net income	$ 2,673	$ 2,804	$ 2,826	$ 2,780
Earnings per share - basic	$ 0.80	$ 0.85	$ 0.85	$ 0.83
Earnings per share - diluted	$ 0.80	$ 0.85	$ 0.85	$ 0.83

(In Thousands, Except Per Share Data)

	FOR THE THREE MONTHS ENDED			
2003	**March 31,**	**June 30,**	**Sept. 30,**	**Dec. 31,**
Interest income	$ 7,092	$ 7,251	$ 7,281	$ 7,608
Interest expense	2,386	2,395	2,327	2,157
Net interest income	4,706	4,856	4,954	5,451
Provision for loan losses	90	45	90	30
Non-interest income	1,182	1,195	1,325	1,273
Securities gains, net	101	1,750	1,247	381
Non-interest expenses	3,139	3,186	3,290	3,674
Income before income tax provision	2,760	4,570	4,146	3,401
Income tax provision	573	1,233	1,135	762
Net income	$ 2,187	$ 3,337	$ 3,011	$ 2,639
Earnings per share - basic	$ 0.72	$ 1.10	$ 1.00	$ 0.53
Earnings per share - diluted	$ 0.72	$ 1.10	$ 0.99	$ 0.54

PART IV

ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements

1. 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 Changes in Shareholders Equity
Consolidated Statement of Cash Flows
Notes to the Consolidated Financial Statements

2. The following schedules is submitted herewith:

I. Indebtedness of Related Parties

The schedules not included are omitted because the required matter or conditions are not present, the data is insignificant or the required information is submitted as part of the consolidated financial statements and notes thereto.

(b) Exhibits:

(23) (iii) Consent of Independent Registered Public Accounting Firm.

(31) (v) Rule 13a-14(a)/Rule 15d-14(a) Certification of Chief Executive Officer

(31) (vi) Rule 13a-14(a)/Rule 15d-14(a) Certification of Principal Accounting Officer

(32) (iii) Section 1350 Certification of Chief Executive Officer

(32) (iv) Section 1350 Certification of Principal Accounting Officer

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.

Dated: August 25, 2005

PENNS WOODS BANCORP, INC.

/s/ Ronald A. Walko
RONALD A. WALKO
President & Chief Executive Officer