CITIZENS FINANCIAL SERVICES INC
Form ARS
March 13, 2007

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As I sit down to write this year's annual letter, I look back at 2006 as a year of major accomplishments and milestones for our Company, Citizens Financial Services, Inc.

It is with great pleasure to report that 2006 was a year of record financial achievement, as consolidated net income reached a record level of $5,800,000, compared to $5,274,000 in 2005, representing an increase of 10.0%. We are extremely proud of this performance, especially since the banking industry continues to be challenged by an ongoing difficult interest rate environment and increased competitive pressures.

Our 2006 performance resulted in earnings per share of $2.04, which represents an increase of 11.5% over 2005 earnings per share of $1.83. This level of performance resulted in a return on average assets of 1.05% and return on average equity of 13.21%, which compares to a return on average assets of 1.04% and return on average equity of 12.63% for 2005. Excluding the first year costs associated with our new Wellsville Office, earnings per share would have been $2.09.

Our record earnings growth was driven by a combination of expense reduction and proactive tax planning strategies to offset overall declining margins, while continuing to grow the bank through our total customer relationship approach as evidenced by an 8.4% growth in loans and a 3.9% growth in deposits during the year.

The Company's balance sheet continued to expand during 2006 with assets ending the year at a record level of $572,168,000. This represents a $42,927,000 or 8.1% increase over 2005. In addition to our loan growth, we took advantage of some market opportunities within our investment portfolio during the course of the year to improve our overall portfolio mix. Because the difficult interest rate environment and increased competition limited deposit growth, we elected to support the addition of assets with borrowed funds. More specifically, we were able to stay true to our sound pricing strategies and manage the impact to our net interest margin by funding our asset growth with short-term borrowings.

Asset quality remains at a very high level and continues to strengthen. During 2006, we experienced net charge-offs of $118,000 representing .03% of average loans. This compares favorably to our peer group. At year end, our classified asset ratio was 17.6% compared to 20.1% in 2005. This also compares favorably to the industry benchmark of 25.0%.

Stockholders' equity increased $1,939,000 to $43,500,000 at December 31, 2006, as earnings outpaced dividends paid and common stock repurchased. Cash dividends of $.86 per share represented an increase of 4.9% over 2005. On January 17, 2006, the Board of Directors approved a plan to repurchase up to 140,000 shares of its common stock. I'm pleased to report that by year-end 54,239 shares of treasury stock have been repurchased in open market or privately negotiated transactions.

Our record accomplishments continued as our Investment and Trust Services Division was able to grow assets under management by 9.8% in 2006 to over $82 million. We continue to strengthen our focus on retirement planning and have recently hired a specialist in this area. The knowledge and experience of our Trust employees and financial consultants gives us the in-house expertise to provide individualized financial solutions to our customers. More information about our Investment and Trust Services Division can be found on pages 6 and 7 of this annual report.

Our attention and energies in 2006 were largely devoted to our Wellsville, New York, branch. In October, we completed construction of our 3,600 square foot permanent facility, less than 12 months after opening the doors to our temporary facility in December 2005. The residents and businesses of the community have welcomed us and have responded positively to our customer relationship approach. Every customer is treated with respect, and we take great pleasure in making their lives more rewarding by meeting their financial needs. This customer relationship approach has resulted in 400 new customers joining the First Citizens family. In addition, our new office has made banking more convenient for the over 800 customers who were already doing business with us.

Everyday I realize how truly blessed I am to be part of this organization and to be working side-by-side with the main reason for our success - our employees. They consistently make quality service a priority and demonstrate, on a daily basis, why First Citizens National Bank is the preferred choice for our customers. In 2006, the number of scams and cases of information theft in the United States and abroad increased to an all time high. First Citizens National Bank handled over 200 fraud cases in 2006 as compared to12 cases just five years ago. Our employees have risen to the challenge of protecting our customers, which is no easy task as the number and variety of scams continues to increase each day. Their awareness and diligence has resulted in minimal losses to both the bank and customers, and as a result, in September, we recognized 61 community office employees for their efforts.

So much of what we do is inspired by a desire to see our communities thrive. In 2006, First Citizens National Bank invested over $54 million in loans to small businesses and municipalities helping to keep jobs local and business communities healthy. We continue to use local vendors and customers to fulfill our product and service needs. Our partnership with the agricultural community grows stronger each day keeping farming alive and well in our markets. As the Number One Mortgage Lender in the Northern Tier, we provided funding to over 1,500 customers to buy or build a new home, or improve the one they already have. Our contributions to libraries, parks, education, health care and culture all play a major role in building better communities. In addition to supporting our communities through economic activity, First Citizens National Bank continues to emphasize community development through the civic involvement of our employees. Their leadership and participation is very important to many civic and charitable organizations that are critical to the overall quality of life in the communities in which we live and operate. Our employees donate thousands of hours each year to schools, youth programs, religious organizations, economic development efforts and other worthy causes.

It is likely that the yield curve will remain inverted or flat in 2007 and consumers will continue to be price-conscious. This will present us with another challenging year. In response, we will remain diligent to the pricing and growth initiatives outlined in our strategic plan, which involves evaluating the economic and competitive markets, as well as thoroughly understanding our customer needs. Opportunities impacting non-interest income and cost control will continue to be evaluated. Meeting the needs of small businesses and understanding the ever-changing issues facing the agricultural industry will remain priorities.

In April, Larry J. Croft retired from our board of directors. Larry joined the Citizens Financial Services, Inc. and First Citizens National Bank boards in 1990 when we acquired Star Savings & Loan where he had served as a director since 1969. His dedication to our customers, employees and shareholders truly made a difference. We sincerely appreciate Larry's years of service, advice and dedication and wish him many happy and healthy years of retirement. At the same time, Robert W. Chappell of our LeRaysville local board and Rinaldo A. DePaola of our Towanda local board were voted in as a Class 3 and Class 1 director respectively at our 2006 Annual Meeting. I invite you to learn more about Larry, Bob and Ray on page 8 of this annual report.

I greatly appreciate the hard work of our board of directors, officers and employees throughout 2006. I also extend my appreciation to you, our shareholders, for your ongoing trust and support of Citizens Financial Services, Inc., including many referrals of new business to First Citizens National Bank.

On June 11, 2007, we will celebrate our 75th year as First Citizens National Bank, a milestone we're very proud of as we are not only celebrating longevity, but financial strength, independence and performance. We will communicate our plans once they are final and hope you can help us celebrate this special event. We look forward to another year of strong financial performance, excitement and rewards.

Randall E. Black
Chief Executive Officer and President

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Our ability to achieve our customers' investment objectives while providing superior customer service has allowed us to grow assets under management to over $82.6 million in 2006, a 9.8% increase from year-end 2005. Our team has grown as well. We added a second Business Development Officer and a Trust Administrator dedicated to the management of trust assets. The group now has over 90 combined years of trust experience and an equally impressive amount of education and training.

Kristen D'Angelo, Trust and Investment Administrator, joined First Citizens in 2005 to add expertise for the management of trust assets. Prior to joining First Citizens, Kristen was the Investment Assistant for the Trust Division of a local community bank. She has earned a Bachelor of Science degree in Accounting from Susquehanna University and is also a graduate of the American Bankers Association National Trust School and the Cannon Financial Institute of Trust Investments.

Jean Knapp, AVP and Trust Officer, has devoted 26 continuous years of service to the Trust Department. Her responsibilities include personal trust administration and a focus on estate settlement. Jean is a graduate of the Central Atlantic School of Trust and the H&R Block Tax Preparation School.

Linda Kriner, VP and Trust Officer, joined First Citizens in 2005, bringing 30 years of trust and estate experience. Prior to joining First Citizens, Linda's job responsibilities included personal trust administration, estate settlement, and business development. She is a graduate of the Central Atlantic School of Trust, the Cannon Financial Institute's Personal Trust School, and the American Bankers Association Graduate Trust School. Linda summed up her feelings about the Department by saying, ***"As Business Development Officer, I'm frequently out of the office and find great comfort in knowing that my clients are in the hands of such experienced and caring people."***

Sara Roupp, AVP and Trust Officer, has devoted over 19 years to our Investment and Trust Services Division. Sara is responsible for business development in Mansfield and the Bradford County area. She also acts as a personal trust administrator and manages the Department's retirement plans. Sara has graduated from the Central Atlantic School of Trust and the American Bankers Association National Trust School, and she currently is studying Business Administration at Mansfield University. When asked about the most satisfying part of her position, Sara commented, ***"I'm in the business of providing peace of mind."***

Sylvia Thompson, Trust Administrator, has worked in our Trust Department for almost eight years. Sylvia is responsible for the operational management of the Department. She has earned a Bachelors Degree in Business Administration from Mansfield University and has graduated from the Central Atlantic School of Trust.

First Citizens continues to strengthen our Investment and Trust Services Division in support of our commitment to meeting all the financial needs of our customers. We recently formed a partnership with UVEST Financial Services that will allow us to be more proactive in managing each customer relationship and will expand the range of investment products and services we offer. Our Financial Consultants will help each customer to determine his or her financial objectives and will provide an investment strategy specifically tailored to achieve those objectives.

Matt Geer, UVEST Financial Consultant, works with our customers in the Wellsboro, Mansfield, Blossburg, Troy, and Canton markets. Matt graduated from the United States Coast Guard Academy with a Bachelors Degree in Business Management.
He holds Series 7 and 63 licenses and has attended the New York Bankers Association Trust and Investment Management School. Prior to joining First Citizens, Matt was an Assistant Portfolio Manager and Securities Trader for Chemung Canal Trust Company and was employed as a Financial Advisor for Morgan Stanley. Matt defines a good day as ***"one where I have helped a customer achieve a higher level, whether a financial success or an understanding and confidence in the plan we developed for their future."***

Jeff Dugan, UVEST Financial Consultant, was a partner of Dugan Tractor, Inc. and manager of Maple Mountain Equipment before joining the Investment and Trust Services Division.
He received a Bachelors Degree in Business Administration from Mansfield University and holds Series 7 and 63 licenses. Jeff served on the Ulysses local board for over 5 years, and his dedication to First Citizens will continue as he supports the Ulysses, Genesee, and Wellsville markets.

Sarah Bresee, UVEST Financial Consultant, serves our Sayre, Towanda, LeRaysville, Gillett, and Millerton offices. Sarah is a Certified Financial Planner and studied financial planning at Boston University.
She holds her Series 7 and 63 licenses. Sarah has worked as a Retirement Planning Specialist at Chemung Canal Trust Company and as a Financial Advisor with AIG VALIC in Binghamton, New York.

Larry J. Croft

Larry Croft joined our Corporate Board of Directors in 1990 when we acquired Star Savings and Loan where he had been a director since 1969.

He has served on many committees of the board. Most recently his expertise had been utilized as chairman of the Credit Committee, member of our Compensation/Human Resource Committee and the Governance and Nominating Committee. Larry has performed his duties and responsibilities as a director with excellence. His years of service are marked by exemplary dedication to the customers, employees and shareholders of this Company.

Larry is currently the owner of Croft Ford Incorporated in Athens, Pennsylvania. He has been associated with this organization for over 40 years. Prior to entering the automobile sales industry, Larry worked for Croft Lumber Company in Sayre, Pennsylvania.

Larry currently resides with his wife Ellen in Litchfield, Pennsylvania. He dedicates his free time to family and his special interests of showing quarter horses and traveling.

Both Bob Chappell and Ray DePaola joined our corporate board in April of 2006. As members of our local Advisory Boards, they understand our customer relationship approach and our commitment to small business, the agricultural industry and community involvement and development. As local board members, they ensure First Citizens has a clear understanding of the needs and goals of the businesses and residents of the communities they represent. As Corporate Board members, Bob and Ray have continued to be the voice of their communities as well as perform duties and responsibilities that provide guidance and direction for our Company.

Robert W. Chappell

Bob is a partner in the law firm of van der Hiel, Chappell & Loomis, doing business in Rome and Mansfield, Pennsylvania. He is a graduate of Widener University School of Law and Mansfield University. Bob served in the United States Marine Corps and

Rinaldo A. DePaola

Ray has been practicing law for 25 years and is currently a partner with the law firm of Griffin, Dawsey, DePaola and Jones, P.C. in Towanda, Pennsylvania. He is a graduate of the Temple Law School and the University of Scranton.

received several commendations for outstanding achievement.

Bob is a member of our LeRaysville local board and is actively involved in organizations such as Betterment Organization of Mansfield (BOOM) and the Northeast Bradford School District.

Bob was born and raised in Rome. He continues to reside there today where he enjoys the outdoors in his free time.

Ray is a member of our Towanda local board. He is actively involved in both civic and professional organizations in the Towanda area including Trustee of Memorial Hospital, the Lions Club and a member of the Board of Directors of Northern Tier Counseling.

Ray is an avid baseball fan, with a passion for the Philadelphia Phillies, traveling to Clearwater Florida each year for spring training. Ray resides in Towanda with his wife, Geri Ann and two children, Frances and Ray.

- Make every customer feel significant - Effectively execute on our core service standards.
- Market to a Segment of One - Segment customers and use a variety of methods to continuously identify their needs and priorities, their satisfaction with our ability to meet those needs and their loyalty to First Citizens.
- Identify and reward loyal customers.

Great Service comes from Great Employees

- Provide employees with the knowledge, skills and motivation to perform consistently well.
- Ensure Integrity at the Top - People won't follow a person they don't trust.
- Create a fun-filled, passionate work environment.
- Consistently hire the best and the brightest.
- Train them well.
- Empower them with the authority to solve customer problems and reward customer loyalty.
- Respect Them.
- Reward Them - Understand what motivates employees, create an environment for them to motivate themselves, and reward desired positive behavior in a timely manner.

- Provide a return on equity that consistently exceeds our peers and meets shareholder expectations.
- Operate and manage the bank in a cost efficient manner which contributes to the overall financial performance without sacrificing customer service and satisfaction.
- Identify, assess and monitor all risks of the bank in such a manner that allows us to maximize returns within our accepted risk tolerance levels.

- Answer the Call - Be proactive in contributing knowledge, skills, time and money to organizations within our community that impact its economic and social vitality.
- Encourage Employee Participation - Support and encourage employee involvement in schools, community groups, professional associations and charities.
- Be a leader and role model for other organizations.

A key attribute of our vision is to exhibit social responsibility and good citizenship by proactively contributing knowledge, skills, time and money to organizations that impact our economy and social vitality.

We support and encourage employee involvement in schools, community groups, professional associations and charities. It is our goal to be a leader and role model for other organizations.

Consumers make better choices when they are well informed. For this reason, First Citizens is committed to making information easily available on subjects that are pertinent to the financial welfare of our customers. At the end of the day, we want our customers to feel good about the decisions they've made.

• Financial Education is incredibly important to our children's futures. For this reason, our employees visit elementary and high schools each year to teach kids about the importance of saving money and to ensure high school students understand the importance of building and maintaining good credit.

• Each year, we deliver or sponsor programs focused on financial subjects related to Retirement Planning, Estate Planning and Small Business issues. In November, we sponsored a seminar for local farmers on Succession Planning and Business Planning and Expansion.

• On a routine basis, we submit articles of interest to our local newspapers on topics such as tips on avoiding financial scams and identity theft, the value of good credit, first-time home buying and understanding investment products.

• In 2006, we introduced two scholarships to Mansfield University. One scholarship is awarded to a member of the community and one to a First Citizens employee, director or family member. The scholarship requirements focus on academic excellence as well as community involvement.

• We continue to sponsor the First Citizens Scholarship Challenge - This academic competition provides high school students throughout the Twin Tiers with the opportunity to showcase their knowledge and receive monetary awards for their schools.

• Our website, ***www.firstcitizensbank.com***, provides many tools for consumer education. Mortgage 101 helps consumers understand the entire home buying process, from determining how much of a home they can afford and the various mortgage programs available, to understanding what happens at the closing. Our Home Improvement Calculator helps consumers estimate the cost of different home projects as well as the amount of their monthly Home Equity Loan Payment. And our Retirement Planning Calculator provides consumers with a tool to determine if their retirement strategy makes sense, no matter what stage of life they may be in.

In order to make a real difference, our monetary donations have been targeted toward children and youth, community development, cultural activities and supporting the many health service organizations that serve our communities.

• In 2006, we made significant financial commitments towards the restoration of the Mansfield and Wellsville Libraries. These centers for learning are an important part of our past and fundamental to our future. We've committed funds to revitalize town parks and movie theatres, and we're proud to have little league teams across the northern tier wear our name on their uniforms.

• Our employees dedicate thousands of hours each year to a variety of civic organizations and charities. From baseball coaches, scout leaders and 4-H leaders to school board members and community development organizations, everywhere you look, you see leadership and participation from our employees and directors.

• Raising money for the American Cancer Society has been a core focus for First Citizens and our employees. Our never-ending efforts have raised over $100,000 for this very worthy cause. To accomplish this, our employees have organized and participated in continuous fundraisers such as auctions and food sales, plus they spend countless hours every year organizing the First Citizens Cancer Classic golf tournament and participating in the Relay for Life Walk-a-Thon.

(in thousands, except share data)	December 31, 2006	2005
ASSETS:		
Cash and cash equivalents:		
Noninterest-bearing	**$ 10,007**	$ 8,498
Interest-bearing	**8**	111
Total cash and cash equivalents	**10,015**	8,609
Available-for-sale securities	**109,743**	102,602
Loans (net of allowance for loan losses:		
2006, $3,876; 2005, $3,664)	**410,897**	379,139
Premises and equipment	**12,892**	12,305
Accrued interest receivable	**2,458**	2,164
Goodwill	**8,605**	8,605
Bank owned life insurance	**8,047**	7,743
Other assets	**9,511**	8,074
TOTAL ASSETS	**$ 572,168**	$ 529,241
LIABILITIES:		
Deposits:		
Noninterest-bearing	**$ 48,509**	$ 50,600
Interest-bearing	**398,006**	379,199
Total deposits	**446,515**	429,799
Borrowed funds	**75,775**	52,674
Accrued interest payable	**2,287**	1,862
Commitment to purchase investment securities	**-**	752
Other liabilities	**4,091**	2,593
TOTAL LIABILITIES	**528,668**	487,680
STOCKHOLDERS' EQUITY:		
Common Stock		
$1.00 par value; authorized 10,000,000 shares;		
issued 2,992,896 and 2,965,257 shares		
in 2006 and 2005, respectively	**2,993**	2,965
Additional paid-in capital	**11,933**	11,359
Retained earnings	**34,007**	31,251
Accumulated other comprehensive loss	**(1,737)**	(1,540)
Treasury stock, at cost:		
172,954 and 118,715 shares for 2006 and 2005, respectively	**(3,696)**	(2,474)
TOTAL STOCKHOLDERS' EQUITY	**43,500**	41,561
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 572,168**	$ 529,241

See accompanying notes to consolidated financial statements.

		Year Ended December 31,				
(in thousands, except per share data)		**2006**		2005		2004
INTEREST AND DIVIDEND INCOME:						
Interest and fees on loans	**$**	**28,101**	$	24,911	$	22,600
Interest-bearing deposits with banks		**-**		3		10
Investment securities:						
Taxable		**3,526**		2,979		3,413
Nontaxable		**903**		596		301
Dividends		**321**		210		282
TOTAL INTEREST AND DIVIDEND INCOME		**32,851**		28,699		26,606
INTEREST EXPENSE:						
Deposits		**11,685**		9,373		8,283
Borrowed funds		**3,268**		1,627		952
TOTAL INTEREST EXPENSE		**14,953**		11,000		9,235
NET INTEREST INCOME		**17,898**		17,699		17,371
Provision for loan losses		**330**		60		-
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES		**17,568**		17,639		17,371
NON-INTEREST INCOME:						
Service charges		**3,140**		2,965		3,017
Trust		**487**		474		434
Brokerage		**166**		183		185
Insurance		**94**		260		175
Investment securities gains (losses), net		**4**		-		(235)
Earnings on bank owned life insurance		**304**		294		307
Other		**521**		512		409
TOTAL NON-INTEREST INCOME		**4,716**		4,688		4,292
NON-INTEREST EXPENSES:						
Salaries and employee benefits		**8,026**		7,645		7,636
Occupancy		**1,123**		1,142		1,072
Furniture and equipment		**593**		658		695
Professional fees		**551**		536		630
Amortization of intangibles		**252**		578		506
Other		**4,482**		4,828		4,383
TOTAL NON-INTEREST EXPENSES		**15,027**		15,387		14,922
Income before provision for income taxes		**7,257**		6,940		6,741
Provision for income taxes		**1,457**		1,666		1,474
NET INCOME	**$**	**5,800**	$	5,274	$	5,267
NET INCOME - EARNINGS PER SHARE	**$**	**2.04**	$	1.83	$	1.82
CASH DIVIDENDS PER SHARE	**$**	**0.86**	$	0.82	$	0.76

See accompanying notes to consolidated financial statements.

(in thousands, except share data)	**Common Stock Shares**	**Common Stock Amount**	**Additional Paid-in Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income(Loss)**	**Treasury Stock**	**Total**
Balance, December 31, 2003	2,909,849	$ 2,910	$ 10,213	$ 26,455	$ 956	$ (2,005)	$ 38,529
Comprehensive income:							
Net income				5,267			5,267
Change in net unrealized loss on securities							
available-for-sale, net of tax benefit of $408					(792)		(792)
Total comprehensive income							4,475
Stock dividend	27,670	28	591	(619)			
Purchase of treasury stock (300 shares)						(6)	(6)
Cash dividends, $.76 per share				(2,209)			(2,209)
Balance, December 31, 2004	2,937,519	2,938	10,804	28,894	164	(2,011)	40,789
Comprehensive income:							
Net income				5,274			5,274
Change in unrecognized pension costs, net							
of tax benefit of $121					(234)		(234)
Change in net unrealized loss on securities							
available-for-sale, net of tax benefit of $758					(1,470)		(1,470)
Total comprehensive income							3,570
Stock dividend	27,738	27	555	(582)			
Purchase of treasury stock (21,453 shares)						(463)	(463)
Cash dividends, $.82 per share				(2,335)			(2,335)
Balance, December 31, 2005	2,965,257	2,965	11,359	31,251	(1,540)	(2,474)	41,561
Comprehensive income:							
Net income				**5,800**			**5,800**
Cumulative effect of change in accounting for							
pension obligation, net of tax benefit of $439					**(852)**		**(852)**
Change in net unrealized loss on securities							
available-for-sale, net of tax expense of $339					**655**		**655**
Total comprehensive income							**5,603**
Stock dividend	**27,639**	**28**	**574**	**(602)**			
Purchase of treasury stock (54,239 shares)						**(1,222)**	**(1,222)**
Cash dividends, $.86 per share				**(2,442)**			**(2,442)**

Balance, December 31, 2006	**2,992,896**	**$**	**2,993**	**$**	**11,933**	**$**	**34,007**	**$**	**(1,737)**	**$**	**(3,696)**	**$ 43,500**

		2006		2005		2004
Components of comprehensive loss:						
Change in net unrealized gain (loss) on investment						
securities available-for-sale	**$**	**658**	$	(1,470)	$	(947)
Change in unrecognized pension costs		**(852)**		(234)		-
Investment losses (gains) included in net income, net						
of tax (benefit) expense of $1, $0, and $(80)		**(3)**		-		155
Total	**$**	**(197)**	$	(1,704)	$	(792)

See accompanying notes to consolidated financial statements.

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	Year Ended December 31,		
(in thousands)	**2006**	2005	2004
Cash Flows from Operating Activities:			
Net income	$ **5,800**	$ 5,274	$ 5,267
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	**330**	60	-
Depreciation and amortization	**899**	1,327	1,444
Amortization and accretion on investment securities	**369**	712	912
Deferred income taxes	**109**	256	(166)
Investment securities (gains) losses, net	**(4)**	-	235
Earnings on bank owned life insurance	**(304)**	(294)	(307)
Realized gains on loans sold	**(61)**	(70)	(54)
Originations of loans held for sale	**(3,317)**	(5,433)	(3,048)
Proceeds from sales of loans held for sale	**3,384**	5,503	3,102
Increase in accrued interest receivable	**(294)**	(429)	(33)
Increase (decrease) in accrued interest payable	**425**	(8)	(18)
Other, net	**(321)**	917	(167)
Net cash provided by operating activities	**7,015**	7,815	7,167
Cash Flows from Investing Activities:			
Available-for-sale securities:			
Proceeds from sales of available-for-sale securities	**10,439**	-	14,045
Proceeds from maturity and principal repayments of securities	**18,697**	17,571	24,571
Purchase of securities	**(36,401)**	(27,366)	(30,122)
Proceeds from redemption of Regulatory Stock	**2,576**	2,702	1,585
Purchase of Regulatory Stock	**(3,723)**	(2,783)	(1,814)
Net increase in loans	**(32,420)**	(23,676)	(15,405)
Purchase of loans	**-**	-	(27,340)
Purchase of premises and equipment	**(1,335)**	(1,306)	(2,319)
Proceeds from sale of premises and equipment	**-**	200	34
Deposit acquisition premium	**-**	-	(2,200)
Proceeds from sale of foreclosed assets held for sale	**405**	486	338
Net cash used in investing activities	**(41,762)**	(34,172)	(38,627)
Cash Flows from Financing Activities:			
Net increase in deposits	**16,716**	10,300	12,720
Proceeds from long-term borrowings	**8,492**	8,594	654
Repayments of long-term borrowings	**(8,787)**	(3,471)	(1,519)
Net increase in short-term borrowed funds	**23,396**	12,577	545
Dividends paid	**(2,442)**	(2,335)	(2,209)
Deposits of acquired branches	**-**	425	20,663
Purchase of treasury stock	**(1,222)**	(463)	(6)
Net cash provided by financing activities	**36,153**	25,627	30,848
Net Increase (decrease) in cash and cash equivalents	**1,406**	(730)	(612)
Cash and Cash Equivalents at Beginning of Year	**8,609**	9,339	9,951

Cash and Cash Equivalents at End of Year	**$**	**10,015**	$	8,609	$	9,339
Supplemental Disclosures of Cash Flow Information:						
Interest paid	**$**	**14,528**	$	10,973	$	9,253
Income taxes paid	**$**	**1,645**	$	1,150	$	1,780
Noncash activities:						
Real estate acquired in settlement of loans	**$**	**463**	$	369	$	718

See accompanying notes to consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business and Organization

Citizens Financial Services, Inc. (individually and collectively, the “Company”), is headquartered in Mansfield, Pennsylvania, and provides a full range of banking and related services through its wholly owned subsidiary, First Citizens National Bank (the “Bank”), and its wholly owned subsidiary, First Citizens Insurance Agency, Inc. The Bank is a national banking association and operates sixteen full-service banking offices in Potter, Tioga and Bradford counties, Pennsylvania and Allegany County, New York. The Bank also provides trust services, including the administration of trusts and estates, retirement plans, and other employee benefit plans, along with a brokerage division that provides a comprehensive menu of investment services. The Bank serves individual and corporate customers and is subject to competition from other financial institutions and intermediaries with respect to these services. The Company is supervised by the Board of Governors of the Federal Reserve System, while the Bank is subject to regulation and supervision by the Office of the Comptroller of the Currency.

A summary of significant accounting and reporting policies applied in the presentation of the accompanying financial statements follows:

Basis of Presentation

The financial statements are consolidated to include the accounts of the Company and its subsidiary, First Citizens National Bank, and its subsidiary, First Citizens Insurance Agency, Inc. These statements have been prepared in accordance with U.S. generally accepted accounting principles. All significant inter-company accounts and transactions have been eliminated in the consolidated financial statements.

In preparing the financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change relate to determination of the allowance for loan losses and deferred tax assets and liabilities.

Operating Segments

Statement of Financial Accounting Standards (FAS) No. 131 requires disclosures about an enterprise’s operating segments in financial reports issued to shareholders. The Statement defines an operating segment as a component of an enterprise that engages in business activities that generates revenue and incurs expense, and the operating results of which are reviewed by the chief operating decision maker in the determination of resource allocation and performance. While the Company’s chief decision makers monitor the revenue streams of the various Company’s products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Consistent with our internal reporting, the Company’s business activities are reported as one segment, which is community banking.

Investment Securities

Investment securities at the time of purchase are classified as one of the three following types:

Held-to-Maturity Securities - includes securities that the Company has the positive intent and ability to hold to maturity. These securities are reported at amortized cost. The Company had no held-to-maturity securities as of December 31, 2006 and 2005.

Trading Securities - includes debt and equity securities bought and held principally for the purpose of selling them in the near term. Such securities are reported at fair value with unrealized holding gains and losses included in earnings. The Company had no trading securities as of December 31, 2006 and 2005.

Available-for-Sale Securities - includes debt and equity securities not classified as held-to-maturity or trading securities. Such securities are reported at fair value, with unrealized holding gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of estimated income tax effect.

The amortized cost of investment in debt securities is adjusted for amortization of premiums and accretion of discounts, computed by a method that results in a level yield. Gains and losses on the sale of investment securities are computed on the basis of specific identification of the adjusted cost of each security.

On a monthly basis the Company evaluates the severity and duration of impairment for its investment securities portfolio to determine if the impairment is other than temporary. Several factors are evaluated and analyzed, including the Company's positive intent and ability to hold the security for a period of time sufficient to allow a market recovery without incurring a loss. When an other than temporary impairment occurs, the investment is written down to the current fair market value with the write-down being reflected as a realized loss.

Common stock of the Federal Reserve Bank and Federal Home Loan Bank represents ownership in institutions which are wholly owned by other financial institutions. These equity securities are accounted for at cost and are classified as other assets.

The fair value of investments, except certain state and municipal securities, is estimated based on bid prices published in financial newspapers or bid quotations received from securities dealers. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations, so fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued.

Loans

Interest on all loans is recognized on the accrual basis based upon the principal amount outstanding. The accrual of interest income on loans is discontinued when, in the opinion of management, there exists doubt as to the ability to collect such interest. Payments received on non-accrual loans are applied to the outstanding principal balance or recorded as interest income, depending upon our assessment of our ultimate ability to collect principal and interest. Loans are returned to the accrual status when factors indicating doubtful collectibility cease to exist.

The Company recognizes nonrefundable loan origination fees and certain direct loan origination costs over the life of the related loan as an adjustment of loan yield using the interest method.

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. 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 which is charged to operations. The provision is based upon management's periodic evaluation of individual loans, the overall risk characteristics of the various portfolio segments, past experience with losses, the impact of economic conditions on borrowers, and other relevant factors. The estimates used in determining the adequacy of the allowance for loan losses are particularly susceptible to significant change in the near term.

Impaired loans are commercial and commercial real estate loans for which it is probable that 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 "non-accrual loans," although the two categories overlap. The Company may choose to place a loan on non-accrual 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 a loan in the process of collection, the difference between the fair value of the collateral and the recorded amount of the loans.

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 is 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 of the 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.

Foreclosed Assets Held For Sale

Foreclosed assets acquired in settlement of loans 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 fair market value of the real estate or other assets to be acquired by a charge to the allowance for loan losses, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of related income and losses on disposition, are included in other expenses and gains are included in other income.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation expense is computed on straight line and accelerated methods over the estimated useful lives of the assets, which range from 3 to 15 years for furniture, fixtures and equipment and 5 to 39 1/2 years for building premises. Repair and maintenance expenditures which extend the useful life of an asset are capitalized and other repair expenditures are expensed as incurred.

When premises or equipment are retired or sold, the remaining cost and accumulated depreciation are removed from the accounts and any gain or loss is credited to income or charged to expense, respectively.

Intangible Assets

Intangible assets include core deposit intangibles, which are a measure of the value of consumer demand and savings deposits acquired in business combinations accounted for as purchases. The core deposit intangibles are being amortized to expense, on average, over a 5 1⁄2 year life on a straight-line basis. The recoverability of the carrying value of intangible assets is evaluated on an ongoing basis, and permanent declines in value, if any, are charged to expense.

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 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 2006 or 2005.

Bank Owned Life Insurance
The Company has purchased life insurance policies on certain officers, 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 other non-interest income.

Income Taxes
The Company and the Bank file a consolidated federal income tax return. Deferred tax assets and liabilities are computed based on the difference between the financial statement basis and income tax basis of assets and liabilities using the enacted marginal tax rates. Deferred income tax expenses or benefits are based on the changes in the net deferred tax asset or liability from period to period.

Employee Benefit Plans
The Company has a noncontributory defined benefit pension plan covering substantially all employees. It is the Company’s policy to fund pension costs on a current basis to the extent deductible under existing tax regulations. Such contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future.
The Company has a defined contribution, 401(k) plan covering eligible employees. The Company contributes a certain percentage of the eligible employee’s compensation into the plan. The employee may also contribute to the plan on a voluntary basis, up to a maximum percentage allowable not to exceed the limits of Code Sections 401(k).
The Company also has a profit-sharing plan for employees which provide tax-deferred salary savings to plan participants. The Company has a deferred compensation plan for directors who have elected to defer all or portions of their fees until their retirement or termination from service.
In 2006, the shareholders of the Company approved a restricted stock plan which covers eligible employees and non-employee corporate directors. Under the plan, awards are granted based upon performance related requirements and are subject to certain vesting criteria.

Mortgage Servicing Rights (MSR’s)
The Company originates certain loans for the express purpose of selling such loans in the secondary market. The Company maintains all servicing rights for these loans. The loans held for sale are carried at lower of cost or market. Originated MSR’s are recorded by allocating total costs incurred between the loan and servicing rights based on their relative fair values. MSR’s are amortized in proportion to the estimated servicing income over the estimated life of the servicing portfolio.

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 of unrealized holding gains (losses) on the available-for-sale securities portfolio and unrecognized pension costs. The Company has elected to report the effects of other comprehensive income as part of the Consolidated Statement of Changes in Stockholders’ Equity.

Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("FAS") No. 155, "Accounting for Certain Hybrid Instruments," as an amendment of FASB Statements No. 133 and 140. FAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In March 2006, the FASB issued FAS No. 156, "Accounting for Servicing of Financial Assets." This statement, which is an amendment to FAS No. 140, will simplify the accounting for servicing assets and liabilities, such as those common with mortgage securitization activities. Specifically, FAS No. 156 addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like (offset) accounting. FAS No. 156 also clarifies when an obligation to service financial assets should be separately recognized as a servicing asset or a servicing liability; requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable; and permits an entity with a separately recognized servicing asset or servicing liability to choose either of the amortization or fair value methods for subsequent measurement. The provisions of FAS No. 156 are effective as of the beginning of the first fiscal year that begins after September 15, 2006. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In September 2006, the FASB issued FAS No. 157, "Fair Value Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In June 2006, the FASB issued FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes." FIN 48 is an interpretation of FAS No. 109, Accounting for Income Taxes, and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. This Interpretation clarifies that management is expected to evaluate an income tax position taken or expected to be taken for likelihood of realization before recording any amounts for such position in the financial statement. FIN 48 also requires expanded disclosure with respect to income tax positions taken that are not certain to be realized. This Interpretation is effective for fiscal years beginning after December 15, 2006, and will require management to evaluate every open tax position that exists in every jurisdiction on the date of initial adoption. The Company is currently evaluating the impact the adoption of the standard will have on the Company's results of operations and financial condition.

In September 2006, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 06-4 ("EITF 06-4"), "Accounting for Deferred Compensation and Post-retirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policy, that are associated with a post-retirement benefit. EITF 06-4 requires that for a split-dollar life insurance arrangement within the scope of the issue, an employer should recognize a liability for future benefits in accordance with FAS No. 106 (if, in substance, a post-retirement benefit plan exists) or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In September 2006, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 06-5("EITF 06-5"), "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance." EITF 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF 06-5 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact the adoption of the standard will have on the Company's results of operations and financial condition.

Treasury Stock
The purchase of the Company's common stock is recorded at cost. At the date of subsequent reissue, the treasury stock account is reduced by the cost of such stock on a last-in-first-out basis.

Cash Flows
The Company utilizes the net reporting of cash receipts and cash payments for deposit and lending activities. The Company considers amounts due from banks and interest-bearing deposits in banks as cash equivalents.

Trust Assets and Income
Assets held by the Company in a fiduciary or agency capacity for its customers are not included in the consolidated financial statements since such items are not assets of the Company.

Earnings Per Share
Earnings per share calculations give retroactive effect to stock dividends declared by the Company. The number of weighted average shares used in the earnings per share computations presented was 2,844,125, 2,884,232, and 2,895,770 for 2006, 2005 and 2004, respectively. The Company has no dilutive securities.

Reclassification
Certain of the prior year amounts have been reclassified to conform with the current year presentation. Such reclassifications had no effect on net income or stockholders' equity.

2. RESTRICTIONS ON CASH AND DUE FROM BANKS
The Bank is required to maintain reserves, in the form of cash and balances with the Federal Reserve Bank, against its deposit liabilities. The amount of such reserves was $844,000 and $814,000 at December 31, 2006 and 2005, respectively.
Non-retirement account deposits with one financial institution are insured up to $100,000. The Company maintains cash and cash equivalents with other financial institutions in excess of the insured amount.

3. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2006 and 2005 were as follows (in thousands):

December 31, 2006		**Amortized Cost**		**Gross Unrealized Gains**		**Gross Unrealized Losses**		**Estimated Fair Value**
Available-for-sale securities:								
U.S. Agency securities	**$**	**16,647**	**$**	**96**	**$**	**(92)**	**$**	**16,651**
Obligations of state and political subdivisions		**22,591**		**92**		**(121)**		**22,562**
Corporate obligations		**7,981**		**21**		**(5)**		**7,997**
Mortgage-backed securities		**60,950**		**90**		**(1,165)**		**59,875**
Equity securities		**2,560**		**98**		**-**		**2,658**
Total available-for-sale	**$**	**110,729**	**$**	**397**	**$**	**(1,383)**	**$**	**109,743**

December 31, 2005		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Estimated Fair Value
Available-for-sale securities:								
U.S. Agency securities	$	12,955	$	-	$	(201)	$	12,754
Obligations of state and political subdivisions		22,697		116		(201)		22,612
Corporate obligations		8,486		142		(1)		8,627
Mortgage-backed securities		57,345		84		(1,577)		55,852
Equity securities		3,099		-		(342)		2,757
Total available-for-sale	$	104,582	$	342	$	(2,322)	$	102,602

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, 2006 and 2005 (in thousands). As of December 31, 2006 and 2005, the Company owned 75 and 79 securities whose market value was less than their cost basis, respectively.

December 31, 2006		**Less than Twelve Months**				**Twelve Months or Greater**				**Total**		
		Estimated Fair Value		**Gross Unrealized Losses**		**Estimated Fair Value**		**Gross Unrealized Losses**		**Estimated Fair Value**		**Gross Unrealized Losses**
U.S. Government agencies and corporations	**$**	**-**	**$**	**-**	**$**	**8,214**	**$**	**92**	**$**	**8,214**	**$**	**92**
Obligations of states and political subdivisions		**8,061**		**57**		**6,637**		**64**		**14,698**		**121**
Corporate obligations		**4,930**		**5**		**-**		**-**		**4,930**		**5**
Mortgage-backed securities		**7,466**		**36**		**39,996**		**1,129**		**47,462**		**1,165**
Total securities	**$**	**20,457**	**$**	**98**	**$**	**54,847**	**$**	**1,285**	**$**	**75,304**	**$**	**1,383**

December 31, 2005	Less than Twelve Months		Twelve Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
U.S. Government agencies and corporations	$ 8,754	$ 82	$ 4,000	$ 119	$ 12,754	$ 201
Obligations of states and political subdivisions	15,005	201	-	-	15,005	201
Corporate obligations	1,505	1	-	-	1,505	1
Mortgage-backed securities	9,470	109	44,350	1,468	53,820	1,577
Total debt securities	34,734	393	48,350	1,587	83,084	1,980
Equity securities	2,757	342	-	-	2,757	342
Total securities	$ 37,491	$ 735	$ 48,350	$ 1,587	$ 85,841	$ 2,322

The Company's investment securities portfolio contains unrealized losses on mortgage-related instruments or other agency securities issued or backed by the full faith and credit of the United States government or are generally viewed as having the implied guarantee of the U.S. government. For fixed maturity investments with unrealized losses due to interest rates where the Company has both 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. For equity securities where the fair value has been significantly below cost for one year, the Company's policy is to recognize an other than temporary impairment unless sufficient evidence is available that the decline is not permanent and a recovery period can be predicted. The Company has concluded that any impairment of its investment securities portfolio outlined in the above table is not permanent, but rather, temporary, and 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.

Proceeds from sales of securities available-for-sale during 2006, 2005, and 2004 were $10,439,000, $0, and $14,045,000, respectively. Gross gains and gross losses were realized on those sales as follows (in thousands):

	2006	2005	2004
Gross gains	**$ 159**	$ -	$ 517
Gross losses	**155**	-	26
Net gains	**$ 4**	$ -	$ 491

In 2004, the Company recorded an other-than-temporary impairment non-cash charge of $726,000 related to $3,825,000 face value of perpetual preferred stock issued by Freddie Mac, a government sponsored entity. Prior to this impairment charge, the decline in value of these securities was recorded as an unrealized marked-to-market loss on securities available for sale and reflected as a reduction in stockholders' equity through other comprehensive income.

Investment securities with an approximate carrying value of $81,894,000 and $83,748,000 at December 31, 2006 and 2005, respectively, were pledged to secure public funds and certain other deposits as provided by law.

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. The amortized cost and estimated carrying value of debt securities at December 31, 2006, by contractual maturity, are shown below (in thousands):

		Amortized Cost		Estimated Fair Value
Available-for-sale securities:				
Due in one year or less	$	**696**	$	**692**
Due after one year through five years		**36,945**		**36,315**
Due after five years through ten years		**24,988**		**24,743**
Due after ten years		**45,540**		**45,335**
Total	$	**108,169**	$	**107,085**

4. LOANS

The Company grants commercial, industrial, residential, and consumer loans primarily to customers throughout Northcentral Pennsylvania and Southern New York. Although the Company has a diversified loan portfolio at December 31, 2006 and 2005, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic conditions within these regions.

Major classifications of loans are as follows (in thousands):

	December 31,			
		2006		2005
Real estate loans:				
Residential	$	**206,059**	$	195,628
Commercial		**94,122**		82,128
Agricultural		**17,054**		12,991
Construction		**7,027**		7,245
Loans to individuals for household,				
family and other purchases		**12,482**		13,017
Commercial and other loans		**32,766**		29,260
State and political subdivision loans		**45,263**		42,534
		414,773		382,803
Less allowance for loan losses		**3,876**		3,664
Loans, net	$	**410,897**	$	379,139

Real estate loans serviced for Freddie Mac and Fannie Mae, which are not included in the consolidated balance sheet, totaled $36,226,000 and $36,306,000 at December 31, 2006 and 2005, respectively.

At December 31, 2006 and 2005, net unamortized loan fees and costs of $996,000 and $890,000, respectively, have been deducted from the carrying value of loans.

The Company had non-accrual loans, inclusive of impaired loans, of $1,668,000 and $1,898,000 at December 31, 2006 and 2005, respectively. Interest income on loans would have increased by approximately $169,000, $144,000 and $87,000 during 2006, 2005 and 2004, respectively, if these loans had performed in accordance with their original terms.

Information with respect to impaired loans as of and for the year ended December 31 is as follows (in thousands):

	2006	2005	2004
Impaired loans without related allowance for loan losses	**$ 469**	$ 673	$ 229
Impaired loans with related allowance for loan losses	**721**	358	832
Related allowance for loan losses	**232**	179	6
Average recorded balance of impaired loans	**1,283**	1,148	1,091
Interest income recognized on impaired loans	**6**	7	