FRANKLIN FINANCIAL SERVICES CORP /PA/
Form 10-Q
November 05, 2018
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

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

For the transition period from__________ to___________

Commission file number 0-12126

FRANKLIN FINANCIAL SERVICES CORPORATION

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	25-1440803
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 South Main Street, Chambersburg, PA	17201-0819
(Address of principal executive offices)	(Zip Code)

(717) 264-6116

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

There were 4,399,135 outstanding shares of the Registrant's common stock as of October 31, 2018.

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Part I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets

(Dollars in thousands, except share and per share data)(unaudited)	September 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$ 16,281	$ 21,433
Interest-bearing deposits in other banks	28,496	37,170
Total cash and cash equivalents	44,777	58,603
Debt securities available for sale, at fair value	125,403	126,971
Equity securities	383	365
Restricted stock	452	456
Loans held for sale	1,072	442
Loans	970,983	943,700
Allowance for loan losses	(12,526)	(11,792)
Net Loans	958,457	931,908
Premises and equipment, net	13,267	13,741
Bank owned life insurance	23,366	22,980
Goodwill	9,016	9,016
Other real estate owned	2,665	2,598
Deferred tax asset, net	4,170	5,803
Other assets	11,596	6,930
Total assets	$ 1,194,624	$ 1,179,813
Liabilities		
Deposits		
Non-interest bearing checking	$ 196,478	$ 196,853
Money management, savings and interest checking	807,643	774,857
Time	67,736	75,471
Total deposits	1,071,857	1,047,181
Other liabilities	8,739	17,488
Total liabilities	1,080,596	1,064,669
Shareholders' equity		
Common stock, $1 par value per share,15,000,000 shares authorized with 4,701,367 shares issued and 4,398,361 shares outstanding at September 30, 2018 and 4,689,099 shares issued and 4,354,788 shares outstanding at December 31, 2017	4,701	4,689
Capital stock without par value, 5,000,000 shares authorized with no shares issued and outstanding	—	—
Additional paid-in capital	41,380	40,396
Retained earnings	81,330	82,218
Accumulated other comprehensive loss	(7,790)	(6,028)

Treasury stock, 303,006 shares at September 30, 2018 and 334,311 shares at December 31, 2017, at cost	(5,593)	(6,131)
Total shareholders' equity	114,028	115,144
Total liabilities and shareholders' equity	$ 1,194,624	$ 1,179,813

The accompanying notes are an integral part of these unaudited financial statements.

Consolidated Statements of Income

(Dollars in thousands, except per share data) (unaudited)	For the Three Months Ended September 30, 2018	2017	For the Nine Months Ended September 30, 2018	2017
Interest income				
Loans, including fees	$ 10,565	$ 9,130	$ 30,268	$ 26,808
Interest and dividends on investments:				
Taxable interest	507	509	1,548	1,558
Tax exempt interest	293	275	862	861
Dividend income	4	2	15	23
Deposits and obligations of other banks	108	147	326	297
Total interest income	11,477	10,063	33,019	29,547
Interest expense				
Deposits	1,101	629	2,847	1,785
Short-term borrowings	21	—	24	15
Total interest expense	1,122	629	2,871	1,800
Net interest income	10,355	9,434	30,148	27,747
Provision for loan losses	250	250	9,579	420
Net interest income after provision for loan losses	10,105	9,184	20,569	27,327
Noninterest income				
Investment and trust services fees	1,424	1,353	4,285	3,991
Loan service charges	191	201	640	657
Deposit service charges and fees	578	611	1,726	1,789
Other service charges and fees	357	340	1,043	996
Debit card income	422	325	1,224	1,062
Increase in cash surrender value of life insurance	129	130	386	391
Net loss on sale of other real estate owned	—	(23)	—	(23)
Debt securities gains, net	5	1	56	3
Change in fair value of equity securities	(20)	—	18	—
Other	34	33	111	186
Total noninterest income	3,120	2,971	9,489	9,052
Noninterest Expense				
Salaries and employee benefits	4,947	4,694	15,029	14,190
Occupancy, furniture and equipment, net	780	809	2,383	2,386
Advertising	345	332	1,113	873
Legal and professional	436	502	1,207	1,173
Data processing	591	567	1,791	1,643
Pennsylvania bank shares tax	239	243	712	728
FDIC Insurance	159	82	452	281
ATM/debit card processing	258	190	734	630
Foreclosed real estate	(8)	24	46	95
Telecommunications	95	106	327	308
Provision for credit losses on off-balance sheet exposures	—	—	2,361	—
Other	729	756	2,253	2,116
Total noninterest expense	8,571	8,305	28,408	24,423
Income before federal income taxes	4,654	3,850	1,650	11,956

Federal income tax expense (benefit)	654	774	(671)	2,517
Net income	$ 4,000	$ 3,076	$ 2,321	$ 9,439
Per share				
Basic earnings per share	$ 0.91	$ 0.71	$ 0.53	$ 2.18
Diluted earnings per share	$ 0.91	$ 0.70	$ 0.53	$ 2.17
Cash dividends declared	$ 0.27	$ 0.24	$ 0.78	$ 0.69

The accompanying notes are an integral part of these unaudited financial statements.

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Consolidated Statements of Comprehensive Income

(Dollars in thousands) (unaudited)	For the Three Months Ended September 30, 2018	2017	For the Nine Months Ended September 30, 2018	2017
Net Income	$ 4,000	$ 3,076	$ 2,321	$ 9,439
Debt Securities:				
Unrealized (losses) gains arising during the period	(638)	(97)	(1,974)	924
Reclassification adjustment included in net income (1)	(5)	(1)	(56)	(3)
Net unrealized (losses) gains	(643)	(98)	(2,030)	921
Tax effect	135	33	469	(313)
Net of tax amount	(508)	(65)	(1,561)	608
Total other comprehensive (loss) income	(508)	(65)	(1,561)	608
Total Comprehensive Income	$ 3,492	$ 3,011	$ 760	$ 10,047

Reclassification adjustment / Statement line item	Tax expense (benefit)			
(1) Debt securities gains, net	$ 1	$ —	$ 12	$ 1

The accompanying notes are an integral part of these unaudited financial statements.

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Consolidated Statements of Changes in Shareholders' Equity

For the three and nine months ended September 30, 2018 and 2017

(Dollars in thousands, except per share data) (unaudited)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance at June 30, 2018	$ 4,700	$ 41,079	$ 78,514	$ (7,282)	$ (5,839)	$ 111,172
Net income	—	—	4,000	—	—	4,000
Other comprehensive loss	—	—	—	(508)	—	(508)
Cash dividends declared, $.27 per share	—	—	(1,184)	—	—	(1,184)
Treasury shares issued under employee stock purchase plan, 381 shares	—	5	—	—	7	12
Treasury shares issued under dividend reinvestment plan, 12,957 shares	—	210	—	—	239	449
Common stock issued under incentive stock option plan, 1,600 shares	1	24	—	—	—	25
Stock option compensation expense	—	62	—	—	—	62
Balance at September 30, 2018	$ 4,701	$ 41,380	$ 81,330	$ (7,790)	$ (5,593)	$ 114,028
Balance at December 31, 2017	$ 4,689	$ 40,396	$ 82,218	$ (6,028)	$ (6,131)	$ 115,144
Cumulative adjustment for fair value of equity securities	—	—	201	(201)	—	—
Net income	—	—	2,321	—	—	2,321
Other comprehensive (loss)	—	—	—	(1,561)	—	(1,561)
Cash dividends declared, $.78 per share	—	—	(3,410)	—	—	(3,410)
Acquisition of 2,605 shares of treasury stock	—	—	—	—	(88)	(88)
Treasury shares issued under employee stock purchase plan, 2,944 shares	—	34	—	—	54	88
Treasury shares issued under dividend reinvestment plan, 30,966 shares	—	513	—	—	572	1,085
Common stock issued under incentive stock option plan, 12,268 shares	12	252	—	—	—	264
Stock option compensation expense	—	185	—	—	—	185
Balance at September 30, 2018	$ 4,701	$ 41,380	$ 81,330	$ (7,790)	$ (5,593)	$ 114,028
Balance at June 30, 2017	$ 4,688	$ 40,096	$ 87,498	$ (3,542)	$ (6,380)	$ 122,360
Net income	—	—	3,076	—	—	3,076
Other comprehensive (loss)	—	—	—	(65)	—	(65)
Cash dividends declared, $.24 per share	—	—	(1,042)	—	—	(1,042)

Treasury shares issued under employee stock purchase plan, 241 shares	—	3	—	—	4	7
Treasury shares issued under dividend reinvestment plan, 5,723 shares	—	85	—	—	105	190
Stock option compensation expense	—	54	—	—	—	54
Balance at September 30, 2017	$ 4,688	$ 40,238	$ 89,532	$ (3,607)	$ (6,271)	$ 124,580
Balance at December 31, 2016	$ 4,688	$ 39,752	$ 83,081	$ (4,215)	$ (6,813)	$ 116,493
Net income	—	—	9,439	—	—	9,439
Other comprehensive income	—	—	—	608	—	608
Cash dividends declared, $.69 per share	—	—	(2,988)	—	—	(2,988)
Treasury shares issued under employee stock purchase plan, 6,568 shares	—	29	—	—	120	149
Treasury shares issued under dividend reinvestment plan, 22,990 shares	—	296	—	—	422	718
Stock option compensation expense	—	161	—	—	—	161
Balance at September 30, 2017	$ 4,688	$ 40,238	$ 89,532	$ (3,607)	$ (6,271)	$ 124,580

The accompanying notes are an integral part of these unaudited financial statements.

Consolidated Statements of Cash Flows

	Nine Months Ended September 30,	
	2018	2017
(Dollars in thousands) (unaudited)		
Cash flows from operating activities		
Net income	$ 2,321	$ 9,439
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	989	973
Net amortization of loans and investment securities	1,307	1,269
Amortization and net change in mortgage servicing rights valuation	—	41
Provision for loan losses	9,579	420
Change in fair value of equity securities	(18)	—
Debt securities gains, net	(56)	(3)
Pay-out of legal settlement	(10,000)	—
Provision for credit losses on off-balance sheet exposures	2,361	—
Loans originated for sale	(16,137)	(6,773)
Proceeds from sale of loans	15,507	6,861
Write-down of other real estate owned	6	60
Acquisition of other real estate owned	105	—
Write-down on premises and equipment available for sale	—	45
Loss on sale of premises	17	23
Increase in cash surrender value of life insurance	(386)	(391)
Stock option compensation	185	161
Contribution to pension plan	(1,000)	—
Increase in other assets	(4,441)	(1,242)
Increase in other liabilities	1,638	2,753
Net cash provided by operating activities	1,977	13,636
Cash flows from investing activities		
Proceeds from sales and calls of investment securities available for sale	4,115	875
Proceeds from maturities and pay-downs of securities available for sale	14,289	16,875
Purchase of investment securities available for sale	(20,276)	(6,533)
Net decrease in restricted stock	4	1,311
Net increase in loans	(36,188)	(17,643)
Capital expenditures	(599)	(871)
Proceeds from sale of other assets	117	154
Net proceeds from the sale of other real estate	32	2,255
Net cash used in investing activities	(38,506)	(3,577)
Cash flows from financing activities		
Net increase in demand deposits, interest-bearing checking, and savings accounts	32,411	50,325
Net (decrease) increase in time deposits	(7,735)	703
Net decrease in short-term borrowings	—	(24,270)
Dividends paid	(3,410)	(2,988)
Treasury shares issued under employee stock purchase plan	88	149
Treasury shares issued under dividend reinvestment plan	1,085	718
Common stock issued under stock option plans	264	—

Net cash provided by financing activities	22,703	24,637
(Decrease) increase in cash and cash equivalents	(13,826)	34,696
Cash and cash equivalents as of January 1	58,603	36,665
Cash and cash equivalents as of September 30	$ 44,777	$ 71,361
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest on deposits and other borrowed funds	$ 2,818	$ 1,786
Income taxes	$ 250	$ 3,405

The accompanying notes are an integral part of these unaudited financial statements.

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FRANKLIN FINANCIAL SERVICES CORPORATION and SUBSIDIARIES

UNAUDITED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Basis of Presentation

The consolidated financial statements include the accounts of Franklin Financial Services Corporation (the Corporation), and its wholly-owned subsidiaries, Farmers and Merchants Trust Company of Chambersburg (the Bank) and Franklin Future Fund Inc. Farmers and Merchants Trust Company of Chambersburg is a commercial bank that has one wholly-owned subsidiary, Franklin Financial Properties Corp. Franklin Financial Properties Corp. holds real estate assets that are leased by the Bank. Franklin Future Fund Inc. is a non-bank investment company. The activities of non-bank entities are not significant to the consolidated totals. All significant intercompany transactions and account balances have been eliminated.

In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations, and cash flows as of September 30, 2018, and for all other periods presented have been made.

Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the audited consolidated financial statements and notes thereto included in the Corporation’s 2017 Annual Report on Form 10-K. The consolidated results of operations for the nine month period ended September 30, 2018 are not necessarily indicative of the operating results for the full year. Management has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

The consolidated balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements.

For purposes of reporting cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits in other banks and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Earnings per share are computed based on the weighted average number of shares outstanding during each period end. A reconciliation of the weighted average shares outstanding used to calculate basic earnings per share and diluted earnings per share follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(Dollars and shares in thousands, except per share data)	2018	2017	2018	2017
Weighted average shares outstanding (basic)	4,391	4,343	4,375	4,332
Impact of common stock equivalents	21	21	24	21
Weighted average shares outstanding (diluted)	4,412	4,364	4,399	4,353

Anti-dilutive options excluded from calculation	—	—	—	—
Net income	$ 4,000	$ 3,076	$ 2,321	$ 9,439
Basic earnings per share	$ 0.91	$ 0.71	$ 0.53	$ 2.18
Diluted earnings per share	$ 0.91	$ 0.70	$ 0.53	$ 2.17

Note 2. Recent Accounting Pronouncements

Standard	Description	Effective Date	Effect on the financial statements or other significant matters
ASU 2018-02, Income Statement (Topic 220), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income	Under ASU 2018-02, entities are allowed, but not required, to reclassify from Accumulated Other Comprehensive Income (AOCI) to retained earnings stranded tax effects resulting from the new federal corporate income tax rate of the Tax Cuts and Jobs Act (the Act). The reclassification could include other stranded tax effects that related to the Act but do not directly related to the change in the federal rate. Tax effects that are stranded in AOCI for other reasons may not be reclassified. Entities also will have an option to adopt the standard retrospectively or in the period of adoption.	January 1, 2018	The Corporation adopted the provisions of the ASU in the fourth quarter of 2017. The Company reclassified the disproportionate tax effect resulting from the Act by increasing retained earnings by $992 thousand and reducing AOCI by $992 thousand.
ASU 2016-15, Statements of Cash Flow (Topic 320): Classification of Certain Cash Receipts and Cash Payments	The standard clarifies how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are intended to reduce diversity in practice. The standard contains additional guidance clarifying when an entity should separate cash receipts and cash payments and classifies them into more than one class of cash flows (including when reasonable judgement is required to estimate and allocate cash flows) versus when an entity should classify the aggregate amount into one class of cash flows on the basis of predominance.	January 1, 2018	The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements.
ASU 2017-07, Employee Benefits Plan (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost	This standard requires an employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. The amendments in this update also allow only the service cost component to be eligible for capitalization when applicable.	January 1, 2018	The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements. The service cost is reported in Salaries and Benefits expense and the nonservice cost is included in Other Expense on the Consolidated Statement of Income, which totaled $107 thousand and was reclassified for the first nine months of 2017.

ASU 2014-09, Revenue from Contracts with Customers (Topic 606)	The amendments in this Update (ASU 2014-09) establish a comprehensive revenue recognition standard. The revenue standard’s core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Three basic transition methods are available – full retrospective, retrospective with certain practical expedients, and a cumulative effect approach.	January 1, 2018	The Corporation adopted this ASU on January 1, 2018, on a modified retrospective approach, and it did not have a material effect on the Corporation's consolidated financial statements. See Note 11. Revenue Recognition for more information.

ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities	The standard amends the guidance on the classification and measurement of financial instruments. Some of the amendments include the following: 1) requires equity investments to be measured at fair value with changes in fair value recognized in net income; 2) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and 4) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value; among others.	January 1, 2018	The Corporation adopted the provisions of the ASU on January 1, 2018 and it had no material effect on the consolidated financial statements. The Corporation reclassified the fair value of equity securities by increasing retained earnings by $201 thousand and decreasing AOCI by $201 thousand. In addition, according to the standard, the Corporation measured the fair value of the loan portfolio beginning March 31, 2018 using an exit price notion. See Note 9. Fair Value Measurements and Fair Values of Financial Instruments for more information.
ASU 2016-02, Leases (Topic 842)	From the lessee's perspective, the new standard established a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as financing. If the lessor doesn't convey risks and rewards or control, an operating lease results.	January 1, 2019	The Corporation currently has real estate and equipment leases that it classifies as operating leases that are not recognized on the balance sheet. Under the new standard, these leases will move onto the balance sheet in the form of a lease liability (the present value of a lessee's obligation to make lease payments) and a right-of-use asset (an asset that represents the lessee's right to use a specified asset for the lease term). The offsetting transactions will gross-up the Consolidated Balance Sheet. The Corporation has identified all of its leases (approximately 63, primarily equipment and property leases), but has not determined the effect on the Consolidated Balance Sheet. The Corporation has acquired a lease accounting model to implement the standard to be used in a test mode during 2018. The Corporation expects to adopt the standard using the modified retrospective approach and elect the transition options of ASU 2018-11. The Corporation currently expects that the new standard will not have a material effect on its consolidated results of operations.

ASU 2018-11, Leases - Targeted Improvements (Topic 842)	This guidance provides entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU No. 2016-02. Specifically, under the amendments in ASU 2018-11: (1) entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02 (January 1, 2019 for the Corporation).		
ASU 2018-15, Accounting for Implementation Costs in a Cloud Computing Arrangement (Topic 350)	This ASU required an entity in a cloud computing arrangement (i.e., hosting arrangement) that is a service contract to follow the internal-use software guidance in ASC 350-40 to determine which implementation costs to capitalize as assets or expense as incurred. Capitalized implementation costs should be presented in the same line item on the balance sheet as amounts prepaid for the hosted service, if any (generally as an "other asset"). The capitalized costs will be amortized over the term of the hosting arrangement, with the amortization expense being presented in the same income statement line item as the fees paid for the hosted service.	January 1, 2019	The Corporation is reviewing its internal accounting procedures for this implementation. The Corporation does not expect the standard will have a material effect on its consolidated results of operations.

ASU 2018-13, Disclosure Framework (Topic 820)	This guidance eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reason for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements.	January 1, 2019	The Corporation is reviewing its financial reporting procedures for this implementation. The Corporation does not expect the standard will have a material effect on its consolidated results of operations.
ASU 2017-04, Goodwill (Topic 350)	This guidance, among other things, removes step 2 of the goodwill impairment test thus eliminating the need to determine the fair value of individual assets and liabilities of the reporting unit. Upon adoption of this standard, goodwill impairment will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. This may result in more or less impairment being recognized than under the current guidance. Early adoption is permitted for any impairment tests performed after January 1, 2017, applied prospectively.	January 1, 2020	The Corporation expects to early adopt the ASU in the fourth quarter of 2018 with the completion of the 2018 impairment analysis. We do not expect this guidance to have a material effect on the Corporation's consolidated financial statements based upon the prior goodwill impairment analysis.
ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments	This standard requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. The ASU replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination (“PCD assets”), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price (“gross up approach”) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.	January 1, 2020	We have formed an implementation team led by the Corporation's Risk Management function. The team is reviewing the requirements of the ASU and evaluating methods and models for implementation. The new standard will result in earlier recognition of additions to the allowance for loan losses and possibly a larger allowance for loan loss balance with a corresponding increase in the provision for loan losses in results of operations; however, the Corporation is continuing to evaluate the impact of the pending adoption of the new standard on its consolidated financial statements. A third-party vendor has been selected to assist with the CECL calculations and the implementation process has started. The Corporation expects to be able to run the CECL model in test mode starting near the end of the first quarter of 2019.

Note 3. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive losses included in shareholders' equity are as follows:

	September 30, 2018	December 31, 2017
(Dollars in thousands)		
Net unrealized (losses) gains on debt securities	$ (2,077)	$ 154
Tax effect	436	(33)
Net of tax amount	(1,641)	121
Accumulated pension adjustment	(7,784)	(7,784)
Tax effect	1,635	1,635
Net of tax amount	(6,149)	(6,149)
Total accumulated other comprehensive loss	$ (7,790)	$ (6,028)

Note 4. Investments

Available for Sale (AFS) Securities

The amortized cost and estimated fair value of AFS securities as of September 30, 2018 and December 31, 2017 are as follows:

(Dollars in thousands) September 30, 2018	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. Government and Agency securities	$ 9,405	$ 15	$ (144)	$ 9,276
Municipal securities	63,221	176	(994)	62,403
Trust preferred securities	4,069	—	(122)	3,947
Agency mortgage-backed securities	46,394	39	(1,063)	45,370
Private-label mortgage-backed securities	474	43	—	517
Asset-backed securities	3,917	—	(27)	3,890
	$ 127,480	$ 273	$ (2,350)	$ 125,403

(Dollars in thousands) December 31, 2017	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Equity securities	$ 164	$ 201	$ —	$ 365
U.S. Government and Agency securities	11,451	64	(43)	11,472
Municipal securities	57,374	650	(252)	57,772
Trust preferred securities	6,000	—	(183)	5,817
Agency mortgage-backed securities	51,307	197	(567)	50,937
Private-label mortgage-backed securities	858	88	—	946
Asset-backed securities	28	—	(1)	27
	$ 127,182	$ 1,200	$ (1,046)	$ 127,336

At September 30, 2018 and December 31, 2017, the fair value of AFS securities pledged to secure public funds and trust deposits totaled $86.9 million and $84.1 million, respectively.

The amortized cost and estimated fair value of debt securities at September 30, 2018, by contractual maturity are shown below. Actual maturities may differ from contractual maturities because of prepayment or call options embedded in the securities.

(Dollars in thousands)	Amortized cost	Fair value
Due in one year or less	$ 14,466	$ 14,508
Due after one year through five years	33,277	33,081
Due after five years through ten years	31,927	31,026
Due after ten years	942	901
	80,612	79,516
Mortgage-backed securities	46,868	45,887
	$ 127,480	$ 125,403

The composition of the net realized gains on AFS securities for the three and nine months ended are as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(Dollars in thousands)	2018	2017	2018	2017
Gross gains realized	$ 5	$ 1	$ 67	$ 3
Gross losses realized	—	—	(11)	—
Net gains realized	$ 5	$ 1	$ 56	$ 3

Impairment:

The AFS investment portfolio contained 192 securities with $100 million of temporarily impaired fair value and $2.4 million in unrealized losses at September 30, 2018. The total unrealized loss position has increased $1.3 million since year-end 2017.

For securities with an unrealized loss, Management applies a systematic methodology in order to perform an assessment of the potential for other-than-temporary impairment. In the case of debt securities, investments considered for other-than-temporary impairment: (1) had a specified maturity or repricing date; (2) were generally expected to be redeemed at par, and (3) were expected to achieve a recovery in market value within a reasonable period of time. In addition, the Bank considers whether it intends to sell these securities or whether it will be forced to sell these securities before the earlier of amortized cost recovery or maturity. The impairment identified on debt securities and subject to assessment at September 30, 2018, was deemed to be temporary and required no further adjustments to the financial statements, unless otherwise noted.

The following table reflects temporary impairment in the AFS portfolio, aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of September 30, 2018 and December 31, 2017:

	September 30, 2018								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	$ 4,011	$ (54)	5	$ 4,381	$ (90)	12	$ 8,392	$ (144)	17
Municipal securities	28,938	(520)	47	13,014	(474)	23	41,952	(994)	70
Trust preferred securities	2,102	(62)	3	1,845	(60)	2	3,947	(122)	5
Agency mortgage-backed securities	18,326	(311)	40	22,996	(752)	53	41,322	(1,063)	93
Asset-backed securities	3,886	(26)	6	4	(1)	1	3,890	(27)	7
Total temporarily impaired securities	$ 57,263	$ (973)	101	$ 42,240	$ (1,377)	91	$ 99,503	$ (2,350)	192

December 31, 2017

	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	$ 2,315	$ (11)	5	$ 3,528	$ (32)	10	$ 5,843	$ (43)	15
Municipal securities	13,767	(89)	22	7,507	(163)	14	21,274	(252)	36
Trust preferred securities	1,216	(12)	2	4,601	(171)	5	5,817	(183)	7
Agency mortgage-backed securities	16,287	(129)	29	20,563	(438)	39	36,850	(567)	68
Asset-backed securities	—	—	—	4	(1)	1	4	(1)	1
Total temporarily impaired securities	$ 33,585	$ (241)	58	$ 36,203	$ (805)	69	$ 69,788	$ (1,046)	127

The following table represents the cumulative credit losses on AFS securities recognized in earnings for:

(Dollars in thousands)	Nine Months Ended September 30, 2018	2017
Balance of cumulative credit-related OTTI at January 1	$ 595	$ 595
Additions for credit-related OTTI not previously recognized	—	—
Additional increases for credit-related OTTI previously recognized when there is no intent to sell and no requirement to sell before recovery of amortized cost basis	—	—
Decreases for previously recognized credit-related OTTI because there was an intent to sell	(323)	—
Reduction for increases in cash flows expected to be collected	—	—
Balance of credit-related OTTI at September 30	$ 272	$ 595

Equity Securities at fair value

The Corporation owns one equity investment. At September 30, 2018, this investment was reported at fair value ($383 thousand) with changes in value reported through income. At December 31, 2017, this investment was reported at fair value with changes in value recorded through other comprehensive income and was included in the Available for Sale Securities table of this note.

Restricted Stock at Cost

The Bank held $452 thousand of restricted stock at September 30, 2018. Except for $30 thousand, this investment represents stock in FHLB Pittsburgh. The Bank is required to hold this stock to be a member of FHLB and it is carried at cost of $100 per share. The level of FHLB stock held is determined by FHLB and is comprised of a minimum membership amount plus a variable activity amount. FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support its operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment.

Note 5. Loans

The Bank reports its loan portfolio based on the primary collateral of the loan. It further classifies these loans by the primary purpose, either consumer or commercial. The Bank's residential real estate loans include long-term loans to individuals and businesses secured by mortgages on the borrower's real property and include home equity loans. Construction loans are made to finance the purchase of land and the construction of residential and commercial buildings thereon, and are secured by mortgages on real estate. Commercial real estate loans include construction, owner and non-owner occupied properties and farm real estate. Commercial loans are made to businesses of various sizes for a variety of purposes including property, plant and equipment, working capital and loans to government municipalities. Commercial lending is concentrated in the Bank's primary market, but also includes purchased loan participations. Consumer loans are comprised of installment loans and unsecured personal lines of credit.

A summary of loans outstanding, by class, at the end of the reporting periods is as follows:

(Dollars in thousands)	September 30, 2018	December 31, 2017
Residential Real Estate 1-4 Family		
Consumer first liens	$ 90,029	$ 97,159
Commercial first lien	60,142	61,275
Total first liens	150,171	158,434
Consumer junior liens and lines of credit	43,044	45,043
Commercial junior liens and lines of credit	5,040	5,328
Total junior liens and lines of credit	48,084	50,371
Total residential real estate 1-4 family	198,255	208,805
Residential real estate - construction		
Consumer	2,779	1,813
Commercial	9,510	8,088
Total residential real estate construction	12,289	9,901
Commercial real estate	475,838	428,428
Commercial	279,835	291,519
Total commercial	755,673	719,947
Consumer	4,766	5,047
	970,983	943,700
Less: Allowance for loan losses	(12,526)	(11,792)
Net Loans	$ 958,457	$ 931,908
Included in the loan balances are the following:		
Net unamortized deferred loan costs	$ 73	$ 98
Loans pledged as collateral for borrowings and commitments from:		
FHLB	$ 762,292	$ 737,313
Federal Reserve Bank	34,685	35,740
	$ 796,977	$ 773,053

Note 6. Loan Quality and Allowance for Loan Losses

The following table presents, by class, the activity in the Allowance for Loan Losses (ALL) for the periods shown:

	Residential Real Estate 1-4 Family							
	First	Junior Liens & Lines of		Commercial				
(Dollars in thousands)	Liens	Credit	Construction	Real Estate	Commercial	Consumer	Unallocated	Total
ALL at June 30, 2018	$ 1,022	$ 318	$ 282	$ 7,028	$ 2,233	$ 107	$ 1,492	$ 12,482
Charge-offs	—	—	—	—	(208)	(23)	—	(231)
Recoveries	—	—	—	1	19	5	—	25
Provision	(16)	(4)	(4)	242	122	12	(102)	250
ALL at September 30, 2018	$ 1,006	$ 314	$ 278	$ 7,271	$ 2,166	$ 101	$ 1,390	$ 12,526
ALL at December 31, 2017	$ 1,060	$ 330	$ 224	$ 6,526	$ 2,110	$ 105	$ 1,437	$ 11,792
Charge-offs	—	—	—	—	(8,944)	(78)	—	(9,022)
Recoveries	1	—	—	17	135	24	—	177
Provision	(55)	(16)	54	728	8,865	50	(47)	9,579
ALL at September 30, 2018	$ 1,006	$ 314	$ 278	$ 7,271	$ 2,166	$ 101	$ 1,390	$ 12,526
ALL at June 30, 2017	$ 1,075	$ 322	$ 281	$ 6,052	$ 2,023	$ 100	$ 1,454	$ 11,307
Charge-offs	—	—	—	(9)	(6)	(31)	—	(46)
Recoveries	1	5	—	17	5	4	—	32
Provision	(15)	(3)	(42)	198	(19)	19	112	250
ALL at September 30, 2017	$ 1,061	$ 324	$ 239	$ 6,258	$ 2,003	$ 92	$ 1,566	$ 11,543
ALL at December 31, 2016	$ 1,105	$ 323	$ 224	$ 6,109	$ 1,893	$ 100	$ 1,321	$ 11,075
Charge-offs	(13)	—	—	(14)	(8)	(83)	—	(118)
Recoveries	2	6	—	17	111	30	—	166
Provision	(33)	(5)	15	146	7	45	245	420
ALL at September 30, 2017	$ 1,061	$ 324	$ 239	$ 6,258	$ 2,003	$ 92	$ 1,566	$ 11,543

The following table presents, by class, loans that were evaluated for the ALL under the specific reserve (individually) and those that were evaluated under the general reserve (collectively) and the amount of the ALL established in each class as of September 30, 2018 and December 31, 2017:

	Residential Real Estate 1-4 Family							
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
September 30, 2018								
Loans evaluated for ALL:								
Individually	$ 408	$ —	$ 460	$ 10,574	$ 3,106	$ —	$ —	$ 14,548
Collectively	149,763	48,084	11,829	465,264	276,729	4,766	—	956,435
Total	$ 150,171	$ 48,084	$ 12,289	$ 475,838	$ 279,835	$ 4,766	$ —	$ 970,983
ALL established for loans evaluated:								
Individually	$ —	$ —	$ —	$ —	$ 181	$ —	$ —	$ 181
Collectively	1,006	314	278	7,271	1,985	101	1,390	12,345
ALL at September 30, 2018	$ 1,006	$ 314	$ 278	$ 7,271	$ 2,166	$ 101	$ 1,390	$ 12,526
December 31, 2017								
Loans evaluated for ALL:								
Individually	$ 459	$ —	$ 466	$ 10,981	$ —	$ —	$ —	$ 11,906
Collectively	157,975	50,371	9,435	417,447	291,519	5,047	—	931,794
Total	$ 158,434	$ 50,371	$ 9,901	$ 428,428	$ 291,519	$ 5,047	$ —	$ 943,700
ALL established for loans evaluated:								
Individually	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Collectively	1,060	330	224	6,526	2,110	105	1,437	11,792
ALL at December 31, 2017	$ 1,060	$ 330	$ 224	$ 6,526	$ 2,110	$ 105	$ 1,437	$ 11,792

The following table shows additional information about those loans considered to be impaired at September 30, 2018 and December 31, 2017:

(Dollars in thousands)	Impaired Loans With No Allowance Recorded Investment	Unpaid Principal Balance	With Allowance Recorded Investment	Unpaid Principal Balance	Related Allowance
September 30, 2018					
Residential Real Estate 1-4 Family					
First liens	$ 754	$ 870	$ —	$ —	$ —
Junior liens and lines of credit	66	66	—	—	—
Total	820	936	—	—	—
Residential real estate - construction	460	531	—	—	—
Commercial real estate	10,715	11,248	—	—	—
Commercial	3,082	10,653	181	181	181
Total	$ 15,077	$ 23,368	$ 181	$ 181	$ 181
December 31, 2017					
Residential Real Estate 1-4 Family					
First liens	$ 869	$ 950	$ —	$ —	$ —
Junior liens and lines of credit	—	—	—	—	—
Total	869	950	—	—	—
Residential real estate - construction	466	531	—	—	—
Commercial real estate	11,061	11,541	—	—	—
Commercial	187	201	—	—	—
Total	$ 12,583	$ 13,223	$ —	$ —	$ —

The following table shows the average of impaired loans and related interest income for the three and nine months ended September 30, 2018 and 2017:

(Dollars in thousands)	Three Months Ended September 30, 2018 Average Recorded Investment	Interest Income Recognized	Nine Months Ended September 30, 2018 Average Recorded Investment	Interest Income Recognized
Residential Real Estate 1-4 Family				
First liens	$ 1,091	$ 10	$ 899	$ 31
Junior liens and lines of credit	268	2	750	2

Total	1,359	12	1,649	33
Residential real estate - construction	461	—	463	—
Commercial real estate	10,789	107	10,314	316
Commercial	3,465	—	5,284	—
Total	$ 16,074	$ 119	$ 17,710	$ 349

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2017	
(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Residential Real Estate 1-4 Family				
First liens	$ 1,157	$ 10	$ 1,152	$ 32
Junior liens and lines of credit	54	—	85	—
Total	1,211	10	1,237	32
Residential real estate - construction	471	—	475	—
Commercial real estate	11,218	109	12,216	328
Commercial	292	—	263	—
Total	$ 13,192	$ 119	$ 14,191	$ 360

The following table presents the aging of payments of the loan portfolio:

(Dollars in thousands)		Loans Past Due and Still Accruing					Total
	Current	30-59 Days	60-89 Days	90 Days+	Total	Non-Accrual	Loans
September 30, 2018							
Residential Real Estate 1-4 Family							
First liens	$ 149,366	$ 503	$ 231	$ —	$ 734	$ 71	$ 150,171
Junior liens and lines of credit	47,907	40	71	43	154	23	48,084
Total	197,273	543	302	43	888	94	198,255
Residential real estate - construction	11,359	70	400	—	470	460	12,289
Commercial real estate	468,202	2,224	3,606	—	5,830	1,806	475,838
Commercial	276,180	328	64	—	392	3,263	279,835
Consumer	4,726	39	1	—	40	—	4,766
Total	$ 957,740	$ 3,204	$ 4,373	$ 43	$ 7,620	$ 5,623	$ 970,983

December 31, 2017							
Residential Real Estate 1-4 Family							
First liens	$ 157,247	$ 485	$ 534	$ —	$ 1,019	$ 168	$ 158,434
Junior liens and lines of credit	50,202	139	30	—	169	—	50,371
Total	207,449	624	564	—	1,188	168	208,805
Residential real estate - construction	9,435	—	—	—	—	466	9,901
Commercial real estate	425,806	421	347	—	768	1,854	428,428
Commercial	291,221	111	—	—	111	187	291,519
Consumer	5,017	23	7	—	30	—	5,047
Total	$ 938,928	$ 1,179	$ 918	$ —	$ 2,097	$ 2,675	$ 943,700

The following table reports the internal credit rating for the loan portfolio. Consumer purpose loans are assigned a rating of either pass or substandard based on the performance status of the loans. Substandard consumer loans are comprised of loans 90 days or more past due and still accruing, and nonaccrual loans. Commercial purpose loans may be assigned any rating in accordance with the Bank's internal risk rating system.