CITIZENS FINANCIAL SERVICES INC
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CONSOLIDATED FINANCIAL HIGHLIGHTS

(dollars in thousands, except per share data)	**2003**	2002
BALANCE SHEET		
Assets	$ **463,878**	$ 432,658
Deposits	**385,691**	373,051
Net Loans	**314,037**	294,836
Investments	**106,587**	100,725
Stockholders' Equity	**38,529**	38,406
STATEMENT OF INCOME		
Interest Income	**25,615**	27,377
Interest Expense	**8,826**	10,404
Net Interest Income	**16,789**	16,973
Net Income	**4,879**	5,595
PER SHARE DATA		
Net Income	**1.72**	1.96
Cash Dividends	**0.74**	0.68
TRUST DEPARTMENT		
Trust Assets Managed	**70,384**	65,171

MESSAGE TO SHAREHOLDERS

To Our Shareholders, Customers and Friends,

The year 2003 was one in which significant changes occurred at Citizens Financial Services, Inc. After serving 22 years as President, Richard E. Wilber announced his retirement. He presided over years of growth and prosperity, and the excellent condition of the Company is testament to his leadership. As Interim President I am pleased to

report that the Company is continuing to prosper, this in great part due to the able staff Dick had in place at the time of his retirement.

A change in leadership can often lead to other changes, such as the loss of key management team members or even something more significant such as a change in ownership. In our case, however, neither occurred. The Board of Directors immediately decided that Citizens Financial Services, Inc. will remain independent. To date, key individuals remain on-board and committed to the success of the Company. We believe our reputation as a quality financial services provider in the three counties we serve will provide a solid foundation for continued growth. The search for the next President is well underway. Needless to say, the process is moving forward carefully and deliberately to ensure we select an individual who is well suited to effectively lead a growing, rural community bank. The shareholders and public will be notified soon after the appointment is made.

These are interesting and unusual economic times. The long period of low interest rates is having considerable impact on the performance of the First Citizens National Bank (the "Bank"), the wholly owned subsidiary of Citizens Financial Services, Inc. In such an environment, the lower rates paid on deposit accounts result in reduced interest expense to the Bank. For the same reason, loan demand increases, especially home mortgages. In fact, in 2003, the Bank originated a record number of loans making us again the number one mortgage lender in the Northern Tier. However, lower interest rates also fuel refinancing which leads to less than expected interest income. These issues challenge banks to effectively manage their net interest income margin in order to continue to experience positive growth in net interest income. I am pleased to report that we succeeded in this challenge by maintaining a net interest margin above peers for the second consecutive year. The low interest rate environment inevitably challenges the Bank s management of its investment portfolio. During 2003 we continued to experience significant cash flow from our mortgage backed securities monthly principal repayments, the proceeds of which were used to support our continued loan growth. Thus it is not surprising the income from the portfolio was less than in 2002.

MESSAGE TO SHAREHOLDERS

Despite the challenges, the Company continued to make good progress. Assets grew to $463.9 million or 7.2% and deposits to $385.7 million or 3.4%. We
experienced 6.5% loan growth or $19.2 million. In addition, $22 million in mortgages were originated and sold, compared to $11.9 million in 2002, thereby reducing the Bank s future exposure to the effects of increasing interest rates. Earnings per share were $1.72 compared with $1.96 in 2002. However, it should be noted for comparison purposes that without the non-recurring charge for Dick Wilber s retirement package, the earnings would have been $1.91. The average value of Citizens Financial stock was $24.00 a share, an increase of 13% over 2002 and 71% over the past two years. Cash dividends of $.74 were paid in 2003 compared to $.68 in 2002.
The Bank s non-interest expense and efficiency ratio are still higher than that of our peers. The Bank continues to identify areas that can be addressed in order to achieve an efficiency ratio more in line with the peer group.

We also recognize the growing need for the effective delivery of Financial Planning and Wealth Management services. We have made significant strides in further developing the relationships of existing customers through the sale of other financial services. We must however, recognize greater efficiencies in this area. A plan to produce higher returns through increased sales and restructuring of costs is near completion.

As I stated earlier, the Board of Directors has made it clear that Citizens Financial Services, Inc. will remain independent and that modest growth is not an option. Therefore, we shall continue to identify opportunities to increase assets that may include the establishment or acquisition of new branches. To ensure sufficient capital is available for such activities, the Board decided in December 2003 to participate in a Trust Preferred transaction. Using Trust Preferred Pooled securities, the Company borrowed $7.5 million at favorable rates and re-invested the proceeds to cover the cost of the borrowing until such time as when the funds may be needed for potential acquisition activities. The year 2004 promises to be an exciting year for Citizens Financial Services, Inc., its shareholders, customers and employees.

In these days of mega bank mergers, we believe that a bank such as ours plays a vital role in contributing to the success of the communities and customers we serve. Citizens Financial Services, Inc. continues to invest both time and money in various organizations that make our towns and villages flourish. We are committed to continuing this support.

It is my pleasure to present this report to you, our shareholders, friends, and employees and thank the Directors for the privilege of serving as Interim President.

Sincerely,

John M. Thomas
Interim President

CONSOLIDATED BALANCE SHEET

(in thousands)	December 31, 2003	December 31, 2002
ASSETS:		
Cash and due from banks:		
Noninterest-bearing	**$ 9,624**	$ 11,173
Interest-bearing	**327**	421
Total cash and cash equivalents	**9,951**	11,594
Available-for-sale securities	**106,587**	100,725
Loans (net of allowance for loan losses 2003, $3,620; 2002, $3,621)	**314,037**	294,836
Premises and equipment	**10,645**	11,245
Accrued interest receivable	**1,703**	1,976
Goodwill	**6,905**	6,905
Core deposit intangible	**978**	1,413
Bank owned life insurance	**7,142**	-
Other assets	**5,930**	3,964
TOTAL ASSETS	**$ 463,878**	$ 432,658

	2003	2002
LIABILITIES:		
Deposits:		
Noninterest-bearing	**$ 46,820**	$ 40,143
Interest-bearing	**338,871**	332,908
Total deposits	**385,691**	373,051
Borrowed funds	**27,796**	17,027
Notes payable	**7,500**	-
Accrued interest payable	**1,888**	2,077
Other liabilities	**2,474**	2,097
TOTAL LIABILITIES	**425,349**	394,252
STOCKHOLDERS' EQUITY:		
Common Stock		
$1.00 par value; authorized 10,000,000 shares;		
issued 2,909,849 and 2,882,070		
shares in 2003 and 2002, respectively	**2,910**	2,882
Additional paid-in capital	**10,213**	9,473
Retained earnings	**26,455**	24,447
TOTAL	**39,578**	36,802
Accumulated other comprehensive income	**956**	2,553
Less: Treasury stock, at cost		
96,962 and 55,162 shares for 2003 and 2002, respectively	**(2,005)**	(949)
TOTAL STOCKHOLDERS' EQUITY	**38,529**	38,406
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 463,878**	$ 432,658

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

(in thousands, except per share data)	Year Ended December 31, **2003**	2002	2001
INTEREST INCOME:			
Interest and fees on loans	**$ 21,593**	$ 21,600	$ 22,163
Interest-bearing deposits with banks	**29**	65	547
Investment securities:			
Taxable	**3,222**	4,711	4,969
Nontaxable	**457**	634	853
Dividends	**314**	367	493

TOTAL INTEREST INCOME		**25,615**		27,377		29,025
INTEREST EXPENSE:						
Deposits		**8,501**		10,012		13,839
Borrowed funds		**325**		392		467
TOTAL INTEREST EXPENSE		**8,826**		10,404		14,306
NET INTEREST INCOME		**16,789**		16,973		14,719
Provision for loan losses		**435**		435		445
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES		**16,354**		16,538		14,274
NON-INTEREST INCOME:						
Service charges		**3,018**		3,130		2,527
Trust		**622**		562		578
Gains on loans sold		**349**		185		31
Realized securities gains, net		**553**		254		657
Other		**770**		915		496
TOTAL NON-INTEREST INCOME		**5,312**		5,046		4,289
NON-INTEREST EXPENSES:						
Salaries and employee benefits		**8,304**		7,120		6,597
Occupancy		**1,025**		998		992
Furniture and equipment		**713**		881		966
Professional fees		**694**		667		494
Amortization of intangibles		**435**		457		1,015
Other		**4,330**		4,103		3,977
TOTAL NON-INTEREST EXPENSES		**15,501**		14,226		14,041
Income before provision for income taxes		**6,165**		7,358		4,522
Provision for income taxes		**1,286**		1,763		765
NET INCOME	**$**	**4,879**	$	5,595	$	3,757
NET INCOME - EARNINGS PER SHARE	**$**	**1.72**	$	1.96	$	1.32
CASH DIVIDENDS PER SHARE	**$**	**0.74**	$	0.68	$	0.64

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(in thousands, except share data)	Common Stock Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income(Loss)	Treasury Stock	Total
Balance, December 31, 2000	2,827,409	$ 2,827	$ 8,670	$ 19,657	$ 344	$ (949)	$ 30,549
Comprehensive income:							
Net income				3,757			3,757
Change in net unrealized gain on securities available-for-sale, net of taxes of $448					869		869
Total comprehensive income							4,626
Stock dividend	27,173	28	347	(375)			
Cash dividends, $.64 per share				(1,786)			(1,786)
Balance, December 31, 2001	2,854,582	2,855	9,017	21,253	1,213	(949)	33,389
Comprehensive income:							
Net income				5,595			5,595
Change in net unrealized gain on securities available-for-sale, net of taxes of $690					1,340		1,340
Total comprehensive income							6,935
Stock dividend	27,488	27	456	(483)			
Cash dividends, $.68 per share				(1,918)			(1,918)
Balance, December 31, 2002	2,882,070	2,882	9,473	24,447	2,553	(949)	38,406
Comprehensive income:							
Net income				**4,879**			**4,879**
Change in net unrealized loss on securities available-for-sale, net of tax benefit of $823					**(1,597)**		**(1,597)**
Total comprehensive income							**3,282**
Stock dividend	**27,779**	**28**	**740**	**(768)**			
						(1,056)	**(1,056)**

Purchase of treasury stock (41,800 shares)								
Cash dividends, $.74 per share				**(2,103)**				**(2,103)**
Balance, December 31, 2003	**2,909,849**	**$ 2,910**	**$ 10,213**	**$ 26,455**		**$ 956**	**$ (2,005)**	**$ 38,529**

	2003	2002	2001
Components of comprehensive income (loss):			
Change in net unrealized gain (loss) on investment securities available-for-sale	$ (1,232)	$ 1,508	$ 1,303
Realized gains included in net income, net of taxes of $188, $86 and $223	(365)	(168)	(434)
Total	$ (1,597)	$ 1,340	$ 869

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
(in thousands)	**2003**	2002	2001
Cash Flows from Operating Activities:			
Net income	**$ 4,879**	$ 5,595	$ 3,757
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	**435**	435	445
Depreciation and amortization	**1,358**	1,447	1,968
Amortization and accretion on investment securities	**1,129**	690	199
Deferred income taxes	**(141)**	116	(279)
Realized gains on securities	**(553)**	(254)	(657)
Increase in cash value of bank owned life insurance	**(142)**	-	-
Realized gains on loans sold	**(349)**	(185)	(31)
Originations of loans held for sale	**(22,435)**	(11,857)	(3,839)
Proceeds from sales of loans held for sale	**23,749**	13,119	2,103
Loss (gain) on sales or disposals of premises and equipment	**-**	(30)	36
Decrease in accrued interest receivable	**273**	10	332
Increase in other assets and intangibles	**(216)**	(429)	(615)

Decrease in accrued interest payable	**(189)**	(208)	(335)
Increase (decrease) in other liabilities	**831**	(8)	478
Net cash provided by operating activities	**8,629**	8,441	3,562
Cash Flows from Investing Activities:			
Available-for-sale securities:			
Proceeds from sale of securities	**12,108**	13,927	35,529
Proceeds from maturity of securities	**49,343**	34,090	13,841
Purchase of securities	**(71,320)**	(32,899)	(63,216)
Net increase in loans	**(20,819)**	(28,045)	(7,218)
Purchase of bank owned life insurance	**(7,000)**	-	-
Acquisition of premises and equipment	**(490)**	(473)	(2,086)
Proceeds from sale of premises and equipment	**-**	275	16
Proceeds from sale of foreclosed assets held for sale	**155**	422	425
Net cash used in investing activities	**(38,023)**	(12,703)	(22,709)
Cash Flows from Financing Activities:			
Net increase in deposits	**12,641**	2,577	2,688
Proceeds from long-term borrowings	**10,702**	1,268	1,993
Repayments of long-term borrowings	**(2,569)**	(949)	(1,720)
Net increase in short-term borrowed funds	**2,636**	3,398	1,834
Proceeds from notes payable	**7,500**	-	-
Dividends paid	**(2,103)**	(1,918)	(1,786)
Acquisition of treasury stock	**(1,056)**	-	-
Net cash provided by financing activities	**27,751**	4,376	3,009
Net increase (decrease) in cash and cash equivalents	**(1,643)**	114	(16,138)
Cash and Cash Equivalents at Beginning of Year	**11,594**	11,480	27,618
Cash and Cash Equivalents at End of Year	**$ 9,951**	$ 11,594	$ 11,480
Supplemental Disclosures of Cash Flow Information:			
Interest paid	**$ 9,015**	$ 10,612	$ 14,641
Income taxes paid	**$ 1,265**	$ 1,755	$ 915
Noncash activities:			
Real estate acquired in settlement of loans	**$ 218**	$ 162	$ 284

See accompanying notes to consolidated financial statements.

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"). The Bank is a national banking association and operates fifteen full-service banking offices in Potter, Tioga and Bradford counties. The Bank also provides trust services, including the administration of trusts and estates, retirement plans, and other employee benefit plans, along with 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 accounting principles generally accepted in the United States of America. All significant intercompany 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.

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. Accordingly, the Company s business activities are currently confined to 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, 2003 and 2002.

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, 2003 and 2002.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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 nonaccrual 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 "nonaccrual loans," although the two categories overlap. The Company may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectibility, while not classifying the loan as impaired if the loan is not a commercial or commercial real estate loan. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for these types of impaired loans is determined by the difference between the present value of the expected cash flows related to the loan, using the original interest rate, and its recorded value; or, as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Mortgage loans on one- to four-family properties and all consumer loans are large groups of smaller balance homogeneous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which 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 foreclosed loans are carried at the lower of fair value minus estimated costs to sell or cost. 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 or charged to income.

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 over a 5 1/2 to 6-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

Goodwill is the excess of the purchase price over the fair value of assets acquired of companies in connection with business acquisitions accounted for as purchases and was being amortized on the straight-line method over 15 years, prior to January 1, 2002. On January 1, 2002, the Company adopted FAS No. 142, Goodwill and Other Intangible Assets , which changed the accounting for goodwill from an amortization method to an impairment-only approach. This statement eliminates the regularly scheduled amortization of goodwill and replaces this method with 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, upon adoption of this Statement, stopped amortizing existing goodwill of $6.9 million. 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 2003 and 2002.

BANK OWNED LIFE INSURANCE

The Company has purchased life insurance policies on certain officers. Bank owned life insurance is recorded at its cash surrender value, or the amount that can be realized.

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, 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 also has a profit-sharing plan which provides tax-deferred salary savings to plan participants.

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 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 exclusively of unrealized holding gains (losses) on the available-for-sale securities portfolio. 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 December 2003, the Financial Accounting Standards Board ("FASB") revised Statement of Financial Accounting Standards ("FAS") No. 132, Employers Disclosures about Pension and Other Postretirement Benefit. This statement retains the disclosures required by FAS No. 132, which standardized the disclosure requirements for pensions and other postretirement benefits to the extent practicable and requires additional information on changes in the benefit obligations and fair value of plan assets. Additional disclosures include information describing the types of plan assets, investment strategy, measurement date(s), plan obligations, cash flows, and components of net periodic benefit cost recognized during interim periods. This statement retains reduced disclosure requirements for nonpublic entities from FAS No. 132, and it includes reduced disclosure for certain of the new requirements. This statement is effective for financial statements with fiscal years ending after December 15, 2003. The interim disclosures required by this statement are effective for interim periods beginning after December 15, 2003. The adoption of this statement did not have a material effect on the Company s disclosure requirements.
In August 2001, the FASB issued FAS No. 143, Accounting for Asset Retirement Obligations , which requires that the fair value of a liability be recognized when incurred for the retirement of a long-lived asset and the value of the asset be increased by that amount. The statement also requires that the liability be maintained at its present value in subsequent periods and outlines certain disclosures for such obligations. The adoption of this statement, which was effective January 1, 2003, did not have a material effect on the Company s financial position or results of operations.
In July 2002, the FASB issued FAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities , which requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. This statement replaces EITF Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring) . The new statement is effective for exit or disposal activities initiated after December 31, 2002. The adoption of this statement did not have a material effect on the Company s financial position or results of operations.
On December 31, 2002, the FASB issued FAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, which amends FAS No. 123, Accounting for Stock-Based Compensation . FAS No. 148 amends the disclosure requirements of FAS No. 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. Under the provisions of FAS No. 123, companies that adopted the preferable, fair value based method were required to apply that method prospectively for new stock option awards. This contributed to a "ramp-up" effect on stock-based compensation expense in the first few years following adoption, which caused concern for companies and investors because of the lack of consistency in reported results. To address that concern, FAS No. 148 provides two additional methods of transition that reflect an entity s full complement of stock-based compensation expense immediately upon adoption, thereby eliminating the ramp-up effect. FAS No. 148 also improves the clarity and prominence of disclosures about the pro forma effects of using the fair value based method of accounting for stock-based compensation for all companies regardless of the accounting method used by requiring that the data be presented more prominently and in a more user-friendly format in the footnotes to the financial statements. In addition, the statement improves the timeliness of those disclosures by requiring that this information be included in interim as well as annual financial statements. The transition guidance and annual disclosure provisions of FAS No. 148 are effective for fiscal years ending after December 15, 2002, with

earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of this statement did not have a material effect on the Company s disclosure requirements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In April, 2003, the FASB issued FAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities . This statement amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under FAS No. 133. The amendments set forth in FAS No. 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. In particular, this statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in FAS No. 133. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. FAS No.149 amends certain other existing pronouncements. Those changes will result in more consistent reporting of contracts that are derivatives in their entirety or that contain embedded derivatives that warrant separate accounting. This statement is effective for contracts entered into or modified after September 30, 2003, except as stated below and for hedging relationships designated after September 30, 2003. The guidance should be applied prospectively. The provisions of this statement that relate to FAS No. 133 Implementation Issues that have been effective for fiscal quarters that began prior to September 15, 2003, should continue to be applied in accordance with their respective effective dates. In addition, certain provisions relating to forward purchases or sales of when-issued securities or other securities that do not yet exist, should be applied to existing contracts as well as new contracts entered into after September 30, 2003. The adoption of this statement did not have a material effect on the Company s financial position or results of operations.
In May 2003, the FASB issued FAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity . This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Such instruments may have been previously classified as equity. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after September 15, 2003. The adoption of this statement did not have a material effect on the Company s reported equity.
In November, 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others . This interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. This interpretation clarifies that a guarantor is required to disclose (a) the nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose, and the events or circumstances that would require the guarantor to perform under the guarantee; (b) the maximum potential amount of future payments under the guarantee; (c) the carrying amount of the liability, if any, for the guarantor s obligations under the guarantee; and (d) the nature and extent of any recourse provisions or available collateral that would enable the guarantor to recover the amounts paid under the guarantee. This interpretation also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee, including its ongoing obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. The objective of the initial measurement of that liability is the fair value of the guarantee at its inception. The initial recognition and initial measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor s fiscal year-end. The disclosure requirements in this interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of this interpretation did not have a material effect on the Company s financial position or results of operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

In January, 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, in an effort to expand upon and strengthen existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of another entity. The objective of this interpretation is not to restrict the use of variable interest entities but to improve financial reporting by companies involved with variable interest entities. Until now, one company generally has included another entity in its consolidated financial statements only if it controlled the entity through voting interests. This interpretation changes that by requiring a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity s activities or entitled to receive a majority of the entity s residual returns or both. The consolidation requirements of this interpretation apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. In October, 2003, the FASB decided to defer to the fourth quarter from the third quarter the implementation date for Interpretation No. 46. This deferral only applies to variable interest entities that existed prior to February 1, 2003. The adoption of this interpretation has not and is not expected to have a material effect on the Company s financial position or results of operations.

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 Bank 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 Bank.

EARNINGS PER SHARE

Earnings per share calculations give retroactive effect to stock dividends declared by the Company. The number of shares used in the earnings per share computations presented was 2,841,633, 2,854,688 and 2,854,688 for 2003, 2002 and 2001, 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 $554,000 and $546,000 at December 31, 2003 and 2002, respectively.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

3. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2003 and 2002, were as follows (in thousands):

December 31, 2003	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Available-for-sale securities:				
U.S. Agency securities	$ 1,005	$ 28	$ -	$ 1,033
Obligations of state and political subdivisions	8,011	292	-	8,303
Corporate obligations	13,656	1,018	-	14,674
Mortgage-backed securities	78,080	671	(375)	78,376
Equity securities	4,387	35	(221)	4,201
Total available-for-sale	$ 105,139	$ 2,044	$ (596)	$ 106,587

December 31, 2002	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Available-for-sale securities:				
U.S. Agency securities	$ 1,008	$ 44	$ -	$ 1,052
Obligations of state and political subdivisions	12,424	307	-	12,731
Corporate obligations	19,845	1,311	-	21,156
Mortgage-backed securities	58,913	1,888	-	60,801
Equity securities	4,667	318	-	4,985
Total available-for-sale	$ 96,857	$ 3,868	$ -	$ 100,725

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, 2003 (in thousands):

	Less than Twelve Months		Twelve Months or Greater		Total	
	Approx Market Value	Gross Unrealized Losses	Approx Market Value	Gross Unrealized Losses	Approx Market Value	Gross Unrealized Losses
Mortgage-backed securities	$ 47,391	$ 375	$ -	$ -	$ 47,391	$ 375
Equity securities	4,166	221	-	-	4,166	221

Total	$	**51,557**	$	**596**	$	**-**	$	**-**	$	**51,557**	$	**596**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The Company's investment securities portfolio contains unrealized losses of mortgage-related instruments 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, and equity securities.
On a monthly basis the Company evaluates the severity and duration of impairment for its investment securities portfolio unless the Company has the ability to hold the security to maturity without incurring a loss. Generally, impairment is considered other than temporary when an investment security has sustained a decline of ten percent or more for six months.
The Company has concluded that any impairment of its investment securities portfolio 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 noncollection of principal and interest during the period.
Proceeds from sales of securities available-for-sale during 2003, 2002, and 2001 were $12,108,000, $13,927,000 and $35,529,000 respectively. Gross gains and gross losses were realized on those sales as follows (in thousands):

	2003		2002		2001	
Gross gains	**$**	**553**	$	287	$	817
Gross losses		-		33		160
Net gains (losses)	**$**	**553**	$	254	$	657

Investment securities with an approximate carrying value of $64,788,000 and $50,733,000 at December 31, 2003 and 2002, 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, 2003, by contractual maturity, are shown below (in thousands):

	Amortized Cost		**Estimated Fair Value**	
Available-for-sale securities:				
Due in one year or less	**$**	**2**	**$**	**2**
Due after one year through five years		**14,725**		**15,494**
Due after five years through ten years		**63,790**		**64,126**
Due after ten years		**22,235**		**22,764**
Total	**$**	**100,752**	**$**	**102,386**

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, 2003 and 2002, a substantial portion of its debtors ability to honor their contracts is dependent on the economic conditions within this region.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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

	December 31, 2003	December 31, 2002
Real estate loans:		
Residential	**$ 180,333**	$ 175,323
Commercial	**57,370**	47,210
Agricultural	**7,594**	9,844
Construction	**5,784**	5,009
Loans to individuals for household, family and other purchases	**13,145**	13,915
Commercial and other loans	**16,219**	18,564
State and political subdivision loans	**37,212**	28,592
	317,657	298,457
Less allowance for loan losses	**3,620**	3,621
Loans, net	**$ 314,037**	$ 294,836

Real estate loans serviced for Freddie Mac, which are not included in the consolidated balance sheet, totaled $35,643,000 and $20,087,000, at December 31, 2003 and 2002, respectively.

At December 31, 2003 and 2002, net unamortized loan fees and costs of $784,000 and $767,000, respectively, have been deducted from the carrying value of loans.

The Company had nonaccrual loans, inclusive of impaired loans, of $2,504,000 and $2,980,000 at December 31, 2003 and 2002, respectively. Interest income on loans would have increased by approximately $49,000, $84,000 and $105,000 during 2003, 2002 and 2001, respectively, if these loans had performed in accordance with their original terms.

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

	2003	2002	2001
Impaired loans without related allowance for loan losses	**$ 1,197**	$ -	$ -
Impaired loans with related allowance for loan losses	**729**	1,916	1,077
Related allowance for loan losses	**35**	327	325
Average recorded balance of impaired loans	**1,772**	1,967	1,078
Interest income recognized on impaired loans	**35**	-	26

Transactions in the allowance for loan losses were as follows (in thousands):

Years Ended December 31,

	2003	2002	2001
Balance, beginning of year	$ **3,621**	$ 3,250	$ 2,777
Provision charged to income	**435**	435	445
Recoveries on loans previously charged against the allowance	**116**	115	175
	4,172	3,800	3,397
Loans charged against the allowance	**(552)**	(179)	(147)
Balance, end of year	$ **3,620**	$ 3,621	$ 3,250

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following is a summary of the past due and nonaccrual loans as of December 31, 2003 and 2002 (in thousands):

	December 31, 2003		
	Past Due 30 - 89 days	Past Due 90 days or more	Nonaccrual
Real estate loans	$ **1,420**	$ **170**	$ **2,491**
Installment loans	**167**	**12**	**13**
Credit cards and related loans	**27**	**-**	**-**
Commercial and all other loans	**38**	**3**	**-**
Total	$ 1,652	$ 185	$ 2,504

	December 31, 2002		
	Past Due 30 - 89 days	Past Due 90 days or more	Nonaccrual
Real estate loans	$ 1,744	$ -	$ 2,980
Installment loans	307	29	-
Credit cards and related loans	36	3	-
Commercial and all other loans	145	7	-
Total	$ 2,232	$ 39	$ 2,980

5. PREMISES & EQUIPMENT

Premises and equipment are summarized as follows (in thousands):

December 31,

	2003	2002
Land	**$ 1,867**	$ 1,867
Buildings	**9,723**	9,681
Furniture, fixtures and equipment	**6,598**	6,476
Construction in process	**32**	21
	18,220	18,045
Less accumulated depreciation	**7,575**	6,800
Premises and equipment, net	**$ 10,645**	$ 11,245

Depreciation expense amounted to $836,000, $990,000, and $953,000 for 2003, 2002, and 2001, respectively.

6. DEPOSITS

Certificates of deposit of $100,000 or more amounted to $41,362,000 and $35,671,000 at December 31, 2003 and 2002, respectively. Interest expense on certificates of deposit of $100,000 or more amounted to $1,618,000, $1,654,000, and $1,976,000 for the years ended December 31, 2003, 2002, and 2001, respectively.

Following are maturities of certificates of deposit as of December 31, 2003 (in thousands):

2004	$ 79,182
2005	44,453
2006	30,384
2007	29,691
2008	15,356
Thereafter	2,493
Total certificates of deposit	$ 201,559

7. BORROWED FUNDS

(dollars in thousands)	Securities Sold Under Agreements to Repurchase(a)	TT&L Borrowings(b)	FHLB Advances(c)	Term Loans(d)	Capital Lease Obligations	Total Borrowed Funds
2003						
Balance at December 31	**$ 8,495**	**$ 2,203**	**$ 1,160**	**$ 15,938**	**$ -**	**$ 27,796**
Highest balance at any month-end	**14,460**	**4,602**	**8,670**	**15,938**	**-**	**43,670**
Average balance	**10,019**	**461**	**2,322**	**1,167**	**-**	**13,969**

Weighted average interest rate:						
Paid during the year	**2.44%**	**2.08%**	**1.29%**	**2.46%**	**0.00%**	**2.24%**
As of year-end	**2.50%**	**0.94%**	**1.03%**	**2.05%**	**0.00%**	**2.05%**
2002						
Balance at December 31	$ 7,647	$ -	$ 7,380	$ 2,000	$ -	$ 17,027
Highest balance at any month-end	14,897	-	7,380	2,000	20	24,297
Average balance	11,096	-	1,208	2,000	6	14,310
Weighted average interest rate:						
Paid during the year	2.69%	-	1.59%	3.64%	4.93%	2.73%
As of year-end	2.94%	-	1.31%	3.13%	0.00%	2.25%
2001						
Balance at December 31	$ 8,322	$ -	$ 2,965	$ 2,000	$ 24	$ 13,311
Highest balance at any month-end	10,758	-	2,965	2,000	67	15,790
Average balance	8,752	-	47	2,000	49	10,848
Weighted average interest rate:						
Paid during the year	4.31%	-	2.00%	5.94%	4.93%	4.60%
As of year-end	3.20%	-	1.88%	3.61%	4.90%	2.97%

(a) Securities sold under agreements to repurchase mature within one to five years. The carrying value of the underlying securities at December 31, 2003 and 2002 was $14,923,000 and $16,936,000, respectively.
(b) TT&L borrowings consist of notes issued under the U.S. Treasury Department's program of investing the treasury tax and loan account balances in interest-bearing demand notes insured by depository institutions. These notes bear interest at a rate of .25 percent less than the average Federal funds rate as computed by the Federal Reserve Bank.
(c) FHLB Advances consist of an "Open RepoPlus" agreement with the Federal Home Loan Bank of Pittsburgh. FHLB "Open RepoPlus" advances are short-term borrowings maturing within one year, bear a fixed rate of interest and are subject to prepayment penalty. The Company has a borrowing limit of $177,390,000, exclusive of any outstanding advances. Although no specific collateral is required to be pledged for the "Open RepoPlus" borrowings, FHLB advances are secured by a blanket security agreement that includes the Company's FHLB stock, as well as investment and mortgage-backed securities held in safekeeping at the FHLB and certain residential mortgage loans. At December 31, 2003 and 2002, the approximate carrying value of the securities collateral was $69,162,000 and $58,722,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(d) Term Loans consist of separate loans with a third party bank and the Federal Home Loan Bank of Pittsburgh as follows (in thousands):

Interest Rate	Maturity	December 31, 2003	December 31, 2002
Variable:			
(e)	August 31, 2004	**$ 938**	$ 2,000
Fixed:			
1.28%	January 20, 2004	**5,000**	
1.81%	June 17, 2005	**3,000**	
2.45%	June 19, 2006	**4,000**	
2.76%	December 18, 2006	**3,000**	
Total term loans		**$ 15,938**	$ 2,000

(e) Interest rate floats monthly based on the 1 month LIBOR +1.75%, the interest rate was 2.92% and 3.19% at December 31, 2003 and 2002, respectively.

Notes Payable:

In December 2003, the Company formed a special purpose entity ("Entity") to issue $7,500,000 of floating rate obligated mandatory redeemable securities as part of a pooled offering. The rate is determined quarterly and floats based on the 3 month LIBOR plus 2.80%. At December 31, 2003, the rate was 3.97%. The Entity may redeem them, in whole or in part, at face value after December 17, 2008. The Company borrowed the proceeds of the issuance from the Entity in December 2003 in the form of a $7,500,000 note payable, which is included in the liabilities section of the Company s balance sheet. Debt issue costs of $75,000 have been capitalized and are being amortized through the first call date.

Under current accounting rules, the Company s minority interest in the Entity was recorded at the initial investment amount and is included in the other assets section of the balance sheet. The Entity is not consolidated as part of the Company s consolidated financial statements.

Following are maturities of borrowed funds and notes payable as of December 31, 2003 (in thousands):

2004	$ 15,445
2005	420
2006	11,215
2007	716
2008	7,500
Total borrowed funds	$ 35,296

8. EMPLOYEE BENEFIT PLANS

The Bank sponsors a trusteed, noncontributory defined benefit pension plan covering substantially all employees and officers. The plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service with the Bank and compensation rates near retirement. The Bank's funding policy is to make annual contributions, if needed, based upon the funding formula developed by the plan's actuary.

Obligations and Funded Status

At December 31 (in thousands):

	Pension Benefits	
	2003	2002
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 3,926**	$ 3,342
Service cost	**340**	269
Interest cost	**267**	229
Amendments	**222**	74
Assumption change	**117**	96
Benefits paid	**(87)**	(84)
Benefit obligation at end of year	**4,785**	3,926
Change in plan assets		
Fair value of plan assets at beginning of year	**3,117**	3,181
Actual return on plan assets	**530**	(371)
Employer contribution	**454**	391
Benefits paid	**(87)**	(84)
Fair value of plan assets at end of year	**4,014**	3,117
Funded status	**(771)**	(809)
Transition adjustment	**(25)**	(39)
Unrecognized prior service cost (benefit)	**23**	21
Unrecognized net gain from past experience different from that assumed	**1,007**	1,010
Prepaid benefit cost	**$ 234**	$ 183

The accumulated benefit obligation for all defined benefit pension plans was $3,638,000 and $2,960,000 at December 31, 2003 and 2002, respectively.

Components of Net Periodic Benefit Cost (in thousands):

	Pension Benefits	
	2003	2002
Service cost	**$ 340**	$ 269
Interest cost	**267**	229
Return on plan assets	**(530)**	371
Net amortization and deferral	**325**	(646)
Net periodic benefit cost	**$ 402**	$ 223

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Assumptions

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

	Pension Benefits	
	2003	2002
Discount rate	**6.25%**	6.50%
Rate of compensation increase	**3.25**	3.50

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

	Pension Benefits	
	2003	2002
Discount rate	**6.25%**	6.50%
Expected long-term return on plan assets	**8.00**	8.00
Rate of compensation increase	**3.25**	3.50

The long-term rate of return on plan assets gives consideration to returns currently being earned on plan assets as well as future rates expected to be earned.

Plan Assets

The Bank's pension plan weighted-average asset allocations at December 31, 2003 and 2002, by asset category are as follows:

	Plan Assets at December 31	
	2003	2002
Equity securities	**67.4%**	55.2%
Debt securities	**30.3**	29.0
Other	**2.3**	15.8
Total	**100.0%**	100.0%

Equity securities include the Bank's common stock in the amounts of $253,000 (6.3% of total plan assets) and $210,000 (6.7% of total plan assets) at December 31, 2003 and 2002, respectively.

The Bank expects to contribute $459,000 to its pension plan in 2004.

9. INCOME TAXES

The provision for income taxes consists of the following (in thousands):

	Years Ended December 31,		
	2003	2002	2001

	2003	2002	2001
Currently payable	**$ 1,427**	$ 1,647	$ 1,044
Deferred liability (benefit)	**(141)**	116	(279)
Provision for income taxes	**$ 1,286**	$ 1,763	$ 765

The following temporary differences gave rise to the net deferred tax assets (liabilities) at December 31, 2003 and 2002 (in thousands):

	2003	2002
Deferred tax assets:		
Allowance for loan losses	**$ 1,038**	$ 1,038
Deferred compensation	**546**	243
Goodwill and core deposit intangibles	**19**	108
Merger & acquisition costs	**24**	34
Foreclosed assets held for sale	**3**	-
Total	**1,630**	1,423
Deferred tax liabilities:		
Unrealized gains on available-for-sale securities	**(492)**	(1,315)
Depreciation and amortization	**(301)**	(259)
Bond accretion	**(81)**	(126)
Pension expense	**(80)**	(62)
Loan fees and costs	**(77)**	(69)
Mortgage servicing rights	**(88)**	(45)
Total	**(1,119)**	(1,876)
Deferred tax asset (liability), net	**$ 511**	$ (453)

No valuation allowance was established at December 31, 2002 in view of certain tax strategies coupled with the anticipated future taxable income as evidenced by the Company's earnings potential.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The total provision for income taxes is different from that computed at the statutory rates due to the following items (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Provision at statutory rates on pre-tax income	**$ 2,096**	$ 2,502	$ 1,537
Effect of tax-exempt income	**(710)**	(693)	(764)

	2003	2002	2001
Tax credits	**(130)**	(130)	(113)
Bank owned life insurance	**(48)**	-	-
Nondeductible interest	**62**	67	97
State income taxes	**-**	9	-
Other items	**16**	8	8
Provision for income taxes	**$ 1,286**	$ 1,763	$ 765
Statutory tax rates	**34%**	34%	34%
Effective tax rates	**20.9%**	24.0%	16.9%

10. RELATED PARTY TRANSACTIONS

Certain executive officers, corporate directors or companies in which they have 10 percent or more beneficial ownership were indebted to the Bank.

A summary of loan activity with officers, directors, stockholders and associates of such persons is listed below (in thousands):

	Years Ended December 31,		
	2003	2002	2001
Balance, beginning of year	**$ 3,678**	$ 3,972	$ 2,814
New loans	**1,243**	847	2,341
Repayments	**(1,576)**	(1,141)	(1,183)
Balance, end of year	**$ 3,345**	$ 3,678	$ 3,972

Such loans were made in the ordinary course of business at the Bank s normal credit terms and do not present more than a normal risk of collection.

11. REGULATORY MATTERS

DIVIDEND RESTRICTIONS:

The approval of the Comptroller of the Currency is required for a national bank to pay dividends up to the Company if the total of all dividends declared in any calendar year exceeds the Bank s net income (as defined) for that year combined with its retained net income for the preceding two calendar years. Under this formula, the Bank can declare dividends in 2004 without approval of the Comptroller of the Currency of approximately $4,901,000, plus the Bank s net income for 2004.

LOANS:

The Bank is subject to regulatory restrictions which limit its ability to loan funds to the Company. At December 31, 2003, the regulatory lending limit amounted to approximately $4,286,000.

REGULATORY CAPITAL REQUIREMENTS:

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

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

of increasingly restrictive regulatory actions.

As of December 31, 2003 and 2002, the Federal Reserve Board and the Office of the Comptroller of the Currency categorized the Company and the Bank as well capitalized, under the regulatory framework for prompt corrective action. To be categorized as a well capitalized financial institution, Total risk-based, Tier I risk-based and Tier I leverage capital ratios must be at least 10%, 6% and 5%, respectively.

The following table reflects the Company s capital ratios at December 31 (in thousands):

	2003		2002	
	Amount	**Ratio**	Amount	Ratio
Total capital (to risk weighted assets)				
Company	**$ 40,655**	**14.07%**	$ 31,036	11.52%
For capital adequacy purposes	**23,115**	**8.00%**	21,552	8.00%
To be well capitalized	**28,894**	**10.00%**	26,939	10.00%
Tier I capital (to risk weighted assets)				
Company	**$ 37,042**	**12.82%**	$ 27,522	10.22%
For capital adequacy purposes	**11,557**	**4.00%**	10,776	4.00%
To be well capitalized	**17,336**	**6.00%**	16,164	6.00%
Tier I capital (to average assets)				
Company	**$ 37,042**	**8.50%**	$ 27,522	6.48%
For capital adequacy purposes	**17,437**	**4.00%**	16,978	4.00%
To be well capitalized	**21,796**	**5.00%**	21,223	5.00%

At December 31, 2003, the Bank s Total capital and Tier I ratios were 11.73% and 10.48%, respectively, and Tier I capital to average assets was 7.03%. At December 31, 2002, the Bank s Total capital and Tier I ratios were 12.13% and 10.85%, respectively, and Tier I capital to average assets was 7.00%.

This annual report has not been reviewed, or confirmed for accuracy or relevance, by the Federal Deposit Insurance Corporation.

12. OFF-BALANCE-SHEET RISK

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate or liquidity risk in excess of the amount recognized in the consolidated balance sheet.

The Company s exposure to credit loss from nonperformance by the other party to the financial instruments for

commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Financial instruments whose contract amounts represent credit risk at December 31, 2003 and 2002, are as follows (in thousands):

	2003	2002
Commitments to extend credit	$ 41,094	$ 33,946
Standby letters of credit	1,404	1,143

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

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

13. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair values of the Company s financial instruments are as follows (in thousands):

	December 31, 2003	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash and due from banks	$ 9,951	$ 9,951
Available-for-sale securities	106,587	106,587
Net loans	314,037	322,813
Bank owned life insurance	7,142	7,142
Regulatory stock	2,540	2,540
Accrued interest receivable	1,703	1,703
Financial liabilities:		
Deposits	$ 385,691	$ 391,282
Borrowed funds	27,796	27,998
Notes payable	7,500	7,500
Accrued interest payable	1,888	1,888

	December 31, 2002	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash and due from banks	$ 11,594	$ 11,594
Available-for-sale securities	100,725	100,725
Net loans	294,836	297,913
Regulatory stock	1,529	1,529
Accrued interest receivable	1,976	1,976
Financial liabilities:		
Deposits	$ 373,051	$ 375,007
Borrowed funds	17,028	17,080
Accrued interest payable	2,077	2,077

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company s entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions can significantly affect the estimates. Estimated fair values have been determined by the Company using historical data, as generally provided in the Company s regulatory reports, and an estimation methodology suitable for each category of financial instruments. The Company s fair value estimates, methods and assumptions are set forth below for the Company s other financial instruments.

CASH AND DUE FROM BANKS:
The carrying amounts for cash and due from banks approximate fair value because they mature in 90 days or less and do not present unanticipated credit concerns.

INVESTMENT SECURITIES:
The fair values of investments are based on quoted market prices as of the balance sheet date. For certain instruments, fair value is estimated by obtaining quotes from independent dealers.
LOANS:
Fair values are estimated for portfolios of loans with similar financial characteristics.
The fair value of performing loans has been estimated by discounting expected future cash flows. The discount rate used in these calculations is derived from the Treasury yield curve adjusted for credit quality, operating expense and prepayment option price, and is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the Company s historical experience with repayments for each loan classification, modified as required by an estimate of the effect of current economic and lending conditions.
Fair value for significant nonperforming loans is based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows, and discount rates are judgmentally determined using available market information and specific borrower information.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

BANK OWNED LIFE INSURANCE:
The carrying value of bank owned life insurance approximates fair value based on applicable redemption provisions.

REGULATORY STOCK:
The carrying value of regulatory stock approximates fair value based on applicable redemption provisions.

DEPOSITS:
The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings and NOW accounts, and money market accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.
The deposits fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market, commonly referred to as the core deposit intangible.

BORROWED FUNDS:
Rates available to the Company for borrowed funds with similar terms and remaining maturities are used to estimate the fair value of borrowed funds.

14. GOODWILL - ADOPTION OF STATEMENT 142
A summary of goodwill is as follows (in thousands):

	December 31,		
	2003	2002	2001
Gross carrying amount	**$ 7,685**	$ 7,685	$ 7,685
Less accumulated amortization	**780**	780	780
Net carrying amount	**$ 6,905**	$ 6,905	$ 6,905

Amortization expense amounted to $512,000 for 2001.
The gross carrying amount of goodwill is tested for impairment in the fourth quarter, after the annual forecasting process. Due to an increase in overall earning asset growth, operating profits and cashflows were greater than expected. Based on the fair value of the reporting unit, estimated using the expected present value of future cashflows, no goodwill impairment loss was recognized in the current year.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

The following table sets forth a comparison of net income and basic earnings per share adjusted for the adoption of

SFAS No. 142, "Goodwill and Other Intangible Assets":
(in thousands, except per share data)

	For the Year Ended December 31,		
	2003	2002	2001
Goodwill amortization	**$ -**	$ -	$ 512
Net Income	**4,879**	5,595	3,757
Addback: Goodwill amortization (net of tax)	**-**	-	338
Adjusted net income	**$ 4,879**	$ 5,595	$ 4,095
Basic earnings per share:			
Net income	**$ 1.72**	$ 1.96	$ 1.32
Goodwill amortization	**-**	-	0.12
Adjusted basic earnings per share	**$ 1.72**	$ 1.96	$ 1.44

15. CORE DEPOSIT INTANGIBLE ASSETS

A summary of core deposit intangible assets is as follows (in thousands) :

	December 31,		
	2003	2002	2001
Gross carrying amount	**$ 2,763**	$ 2,763	$ 2,763
Less accumulated amortization	**1,785**	1,350	893
Net carrying amount	**$ 978**	$ 1,413	$ 1,870

Amortization expense amounted to $435,000, $457,000 and $503,000 for 2003, 2002 and 2001, respectively.

The estimated amortization expense of intangible assets for each of the five succeeding fiscal years is as follows:
(in thousands) :

	Core deposit intangibles
For the year ended December 31, 2004	$ 435
For the year ended December 31, 2005	435
For the year ended December 31, 2006	108
For the year ended December 31, 2007	-
For the year ended December 31, 2008	-

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

16. CONDENSED FINANCIAL INFORMATION - PARENT COMPANY ONLY

CITIZENS FINANCIAL SERVICES, INC.
CONDENSED BALANCE SHEET

(in thousands)	December 31, 2003	December 31, 2002
Assets:		
Cash	**$ 7,680**	$ 68
Investment in subsidiary,		
First Citizens National Bank	**39,241**	39,978
Available-for-sale securities	**-**	416
Other assets	**306**	13
Total assets	**$ 47,227**	$ 40,475
Liabilities:		
Other liabilities	**$ 260**	$ 23
Deferred tax liability	-	46
Notes payable	**7,500**	-
Borrowed funds	**938**	2,000
Total liabilities	**$ 8,698**	$ 2,069
Stockholders' equity	**38,529**	38,406
Total liabilities and stockholders' equity	**$ 47,227**	$ 40,475

CITIZENS FINANCIAL SERVICES, INC.
CONDENSED STATEMENT OF INCOME

(in thousands)	Year Ended December 31, 2003	2002	2001
Dividends from:			
Bank subsidiary	**$ 4,142**	$ 1,478	$ 481
Available-for-sale securities	**3**	19	44
Interest-bearing deposits with banks	**-**	2	22
Total income	**4,145**	1,499	547
Realized securities gains, net	**150**	178	189
Expenses	**186**	213	264
Income before equity			

in undistributed earnings			
of subsidiary	**4,109**	1,464	472
Equity in undistributed			
earnings - First Citizens National Bank	**770**	4,131	3,285
Net income	**$ 4,879**	$ 5,595	$ 3,757

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

CITIZENS FINANCIAL SERVICES, INC.
STATEMENT OF CASH FLOWS

	Year Ended December 31,		
(in thousands)	**2003**	2002	2001
Cash flows from operating activities:			
Net income	**$ 4,879**	$ 5,595	$ 3,757
Adjustments to reconcile net income to net			
cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	**(770)**	(4,131)	(3,285)
Deferred income taxes	**-**	-	3
Realized gains on securities	**(150)**	(178)	(189)
Decrease (increase) in other assets	**(293)**	11	35
Increase (decrease) in other liabilities	**238**	1	(4)
Net cash provided by operating activities	**3,904**	1,298	317
Cash flows from investing activities:			
Purchase of available-for-sale securities	**-**	-	(418)
Proceeds from the sale of available-for-sale securities	**429**	621	2,283
Additional contribution in subsidiaries	**-**	-	(500)
Net cash provided by investing activities	**429**	621	1,365
Cash flows from financing activities:			
Cash dividends paid	**(2,103)**	(1,918)	(1,786)
Advances of borrowed funds	**1,055**	-	-
Repayments of borrowed funds	**(2,117)**	-	-
Acquisition of treasury stock	**(1,056)**	-	-
Proceeds from notes payable	**7,500**	-	-
Net cash provided by (used in) financing activities	**3,279**	(1,918)	(1,786)

Net increase (decrease) in cash	**7,612**	1	(104)
Cash at beginning of year	**68**	67	171
Cash at end of year	**$ 7,680**	$ 68	$ 67

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

17. CONDENSED QUARTERLY DATA

CONSOLIDATED QUARTERLY DATA

(dollar amounts in thousands)	Three Months Ended			
2003	**Mar 31**	**Jun 30**	**Sep 30**	**Dec 31**
Interest income	**$ 6,520**	**$ 6,401**	**$ 6,329**	**$ 6,365**
Interest expense	**2,313**	**2,264**	**2,149**	**2,100**
Net interest income	**4,207**	**4,137**	**4,180**	**4,265**
Provision for loan losses	**135**	**120**	**120**	**60**
Non-interest income	**1,095**	**1,270**	**1,212**	**1,182**
Realized securities gains, net	**259**	**141**	**114**	**39**
Non-interest expenses	**3,631**	**3,631**	**4,490**	**3,749**
Income before provision for income taxes	**1,795**	**1,797**	**896**	**1,677**
Provision for income taxes	**430**	**415**	**90**	**351**
Net income	**$ 1,365**	**$ 1,382**	**$ 806**	**$ 1,326**
Earnings Per Share	**$ 0.48**	**$ 0.48**	**$ 0.28**	**$ 0.47**

	Three Months Ended			
2002	Mar 31	Jun 30	Sep 30	Dec 31
Interest income	$ 6,867	$ 6,825	$ 6,894	$ 6,791
Interest expense	2,723	2,632	2,558	2,491
Net interest income	4,144	4,193	4,336	4,300
Provision for loan losses	120	90	90	135
Non-interest income	1,201	1,154	1,177	1,260
Realized securities gains, net	30	186	38	-

Non-interest expenses	3,467	3,590	3,571	3,598
Income before provision for income taxes	1,788	1,853	1,890	1,827
Provision for income taxes	428	438	459	438
Net income	$ 1,360	$ 1,415	$ 1,431	$ 1,389
Earnings Per Share	$ 0.48	$ 0.50	$ 0.50	$ 0.49

18. SUBSEQUENT EVENT

On February 25, 2004 the Company announced that they have entered into a definitive agreement whereby the Company has purchased two branch locations from Legacy Bank. Under the terms of the agreement, the Company will acquire approximately $24 million in loans and $21 million in deposits, in addition to assuming the lease costs of the branches. This acquisition has been approved by the Company s board of directors and is expected to close in the second quarter of 2004.

REPORT OF INDEPENDENT AUDITORS

To the Stockholders and Board of Directors of
Citizens Financial Services, Inc.

We have audited the consolidated balance sheet of Citizens Financial Services, Inc. and subsidiary as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in stockholders equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citizens Financial Services, Inc. and subsidiary as of December 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

Wexford, PA
January 16, 2004
except for Note 18, as to which the date is February 25, 2004

S.R. Snodgrass, A.C.
1000 Stonewood Drive, Suite 200 Wexford, PA 15090-8399 Phone: 724-934-0344 Facsimile: 724-934-0345

SELECTED FINANCIAL DATA

FIVE YEAR SUMMARY OF OPERATIONS

(dollar amounts in thousands)	**2003**	2002	2001	2000	1999
Interest income	**$ 25,615**	$ 27,377	$ 29,025	$ 26,226	$ 23,546
Interest expense	**8,826**	10,404	14,306	14,238	12,066
Net interest income	**16,789**	16,973	14,719	11,988	11,480
Provision for loan losses	**435**	435	445	610	475
Net interest income after provision for loan losses	**16,354**	16,538	14,274	11,378	11,005
Non-interest income	**4,759**	4,792	3,632	2,670	2,345
Realized securities gains (losses), net	**553**	254	657	(9)	279
Non-interest expenses	**15,501**	14,226	14,041	10,187	9,033
Income before provision for income taxes and extraordinary item	**6,165**	7,358	4,522	3,852	4,596
Provision for income taxes	**1,286**	1,763	765	644	1,043
Net income	**$ 4,879**	$ 5,595	$ 3,757	$ 3,208	$ 3,553
Per share data:					
Net income (1)	**$ 1.72**	$ 1.96	$ 1.32	$ 1.12	$ 1.22
Cash dividends (1)	**0.740**	0.680	0.640	0.600	0.560
Book value (1)	**13.70**	13.45	11.70	10.69	9.33
Total investments	**$ 106,587**	$ 100,725	$ 113,604	$ 97,984	$ 90,031
Loans, net (2)	**314,037**	294,836	268,464	260,209	229,159
Total assets (2)	**463,878**	432,658	421,110	413,332	340,779
Total deposits (2)	**385,691**	373,051	370,474	367,785	284,318
Stockholders' equity	**38,529**	38,406	33,389	30,549	27,082

(1) Amounts were adjusted to reflect stock dividends
(2) Amounts in 2000 reflect the acquisition of branches in the fourth quarter of 2000

SELECTED FINANCIAL DATA (CONTINUED)

COMMON STOCK

Common stock issued by Citizens Financial Services, Inc. is traded in the local over-the-counter market, primarily in Pennsylvania and New York. Prices presented in the table below are bid/ask prices between broker-dealers published by the National Association of Securities Dealers through the NASD OTC "Bulletin Board", its automated quotation system for non-NASDAQ quoted stocks and the National Quotation Bureau s "Pink Sheets." The prices do not include retail markups or markdowns or any commission to the broker-dealer. The bid prices do not necessarily reflect prices in actual transactions. Cash dividends are declared on a quarterly basis and the effects of stock dividends have been stated retroactively in the table below (also see dividend restrictions in Note 11).

	2003			2002		
	High	Low	Dividends declared per share	High	Low	Dividends declared per share
First quarter	**$ 22.47**	**$ 20.30**	**$ 0.180**	$ 16.75	$ 13.50	$ 0.165
Second quarter	**28.02**	**22.52**	**0.185**	17.50	16.80	0.170
Third quarter	**27.40**	**26.98**	**0.185**	19.35	17.00	0.170
Fourth quarter	**24.75**	**22.50**	**0.190**	21.80	19.35	0.175

TRUST AND INVESTMENT SERVICES FUNDS UNDER MANAGEMENT (MARKET VALUE)

	2003	2002
INVESTMENTS:		
Bonds	**$ 11,806**	$ 13,153
Stock	**22,384**	20,783
Savings and Money Market Funds	**10,837**	11,168
Mutual Funds	**22,831**	18,257
Mortgages	**868**	936
Real Estate	**994**	816
Miscellaneous	**193**	29
Cash	**471**	29
TOTAL	**$ 70,384**	$ 65,171
ACCOUNTS:		
Estates	**$ 2,377**	$ 1,016
Trusts	**22,908**	25,134
Guardianships	**106**	184
Employee Benefits	**22,088**	19,490
Investment Management	**18,000**	13,377
Custodial	**4,905**	5,970
TOTAL	**$ 70,384**	$ 65,171

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENT

Forward-looking statements may prove inaccurate. We have made forward-looking statements in this document, and in documents that we incorporate by reference, that are subject to risks and uncertainties. Forward-looking statements include information concerning possible or assumed future results of operations of Citizens Financial Services, Inc., First Citizens National Bank, First Citizens Insurance Agency, Inc. or the combined Company. When we use such words as "believes," "expects," "anticipates," or similar expressions, we are making forward-looking statements. For a variety of reasons, actual results could differ materially from those contained in or implied by forward-looking statements:

- Interest rates could change more rapidly or more significantly than we expect.
- The economy could change significantly in an unexpected way, which would cause the demand for new loans and the ability of borrowers to repay outstanding loans to change in ways that our models do not anticipate.
- The stock and bond markets could suffer a significant disruption, which may have a negative effect on our financial condition and that of our borrowers, and on our ability to raise money by issuing new securities.
- It could take us longer than we anticipate to implement strategic initiatives designed to increase revenues or manage expenses, or we may be unable to implement those initiatives at all.
- Acquisitions and dispositions of assets could affect us in ways that management has not anticipated.
- We may become subject to new legal obligations or the resolution of litigation may have a negative effect on our financial condition.
- We may become subject to new and unanticipated accounting, tax, or regulatory practices or requirements.

INTRODUCTION

The following is management s discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in its accompanying consolidated financial statements for Citizens Financial Services, Inc., a bank holding company and its subsidiary (the Company). Our Company s consolidated financial condition and results of operations consist almost entirely of our wholly owned subsidiary s (First Citizens National Bank) financial conditions and results of operations. Management s discussion and analysis should be read in conjunction with the audited consolidated financial statements and related notes. Except as noted, tabular information is presented in thousands of dollars.

Our Company currently engages in the general business of banking throughout our service area of Potter, Tioga and Bradford counties in North Central Pennsylvania and Allegany, Steuben, Chemung and Tioga counties in Southern New York. We maintain our central office in Mansfield, Pennsylvania. Presently we operate banking facilities in Mansfield, Blossburg, Ulysses, Genesee, Wellsboro, Troy, Sayre, Canton, Gillett, Millerton, LeRaysville, Towanda, the Wellsboro Weis Market store and the Mansfield Wal-Mart Super center. Additionally, we have automatic teller machines (ATMs) located in Soldiers and Sailors Memorial Hospital in Wellsboro and at Mansfield University. Our lending and deposit products and investment services are offered primarily within our service area.

Risk identification and management are essential elements for the successful management of the Company. In the normal course of business, the Company is subject to various types of risk, including interest rate, credit and liquidity risk.

Interest rate risk is the sensitivity of net interest income and the market value of financial instruments to the direction and frequency of changes in interest rates. Interest rate risk results from various re-pricing frequencies and the maturity structure of the financial instruments owned by the Company. The Company uses its asset/liability and funds management policy to control and manage interest rate risk.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Credit risk represents the possibility that a customer may not perform in accordance with contractual terms. Credit risk results from loans with customers and the purchasing of securities. The Company s primary credit risk is in the loan portfolio. The Company manages credit risk by adhering to an established credit policy and through a disciplined evaluation of the adequacy of the allowance for loan losses. Also, the investment policy limits the amount of credit risk that may be taken in the investment portfolio.

Liquidity risk represents the inability to generate or otherwise obtain funds at reasonable rates to satisfy commitments to borrowers and obligations to depositors. The Company has established guidelines within its asset/liability and funds management policy to manage liquidity risk. These guidelines include contingent funding alternatives.

Readers should carefully review the risk factors described in other documents our Company files from time to time with the Securities and Exchange Commission, including the quarterly reports on Form 10-Q and any current reports on Form 8-K filed by us.

We face strong competition in the communities we serve from other commercial banks, savings banks, and savings and loan associations, some of which are substantially larger institutions than our subsidiary. In addition, insurance companies, investment-counseling firms, and other business firms and individuals offer personal and corporate trust services. We also compete with credit unions, issuers of money market funds, securities brokerage firms, consumer finance companies, mortgage brokers and insurance companies. These entities are strong competitors for virtually all types of financial services.

In recent years, the financial services industry has experienced tremendous change to competitive barriers between bank and non-bank institutions. We not only must compete with traditional financial institutions, but also with other business corporations that have begun to deliver competing financial services. Competition for banking services is based on price, nature of product, quality of service, and in the case of certain activities, convenience of location.

TRUST AND INVESTMENT SERVICES

Our Trust & Investment Department services range from professional estate settlement services through management of complex trust accounts to investment management and custody of securities. Our Investment and Trust Department manages retirement accounts for many area companies and individuals. We also manage many individual IRAs, both rollover and contributory.

The Investment Department offers full service brokerage services in selected locations throughout the Bank s market area and appointments can be made in any First Citizens National Bank branch.

The Bank offers annuities and life insurance through our insurance subsidiary, First Citizens Insurance Agency, Inc.

FINANCIAL CONDITION

The following table presents ending balances (dollars in millions), growth (reduction) and the percentage change during the past two years:

	2003 Balance	**Increase (Decrease)**	**% Change**	2002 Balance	Increase (Decrease)	% Change	2001 Balance
Total assets	**$ 463.9**	**$ 31.2**	**7.2**	$ 432.7	$ 11.6	2.8	$ 421.1
Total loans, net	**314.0**	**19.2**	**6.4**	294.8	26.3	9.8	268.5
Total investments	**106.6**	**5.9**	**5.9**	100.7	(12.9)	(11.4)	113.6
Total deposits	**385.7**	**12.6**	**3.4**	373.1	2.6	0.7	370.5
Total stockholders' equity	**38.5**	**0.1**	**0.3**	38.4	5.0	15.0	33.4

CASH AND CASH EQUIVALENTS

Cash and cash equivalents totaled $9,951,000 at December 31, 2003 compared to $11,594,000 at December 31, 2002.

Non-interest bearing cash decreased $1,549,000 since December 31, 2002, while interest-bearing cash decreased $94,000 during that same time period.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

We believe the Company s liquidity needs are satisfied by the current balance of cash and cash equivalents, readily available access to traditional funding sources, Federal Home Loan Bank financing, and the portion of the investment and loan portfolios that mature within one year. These sources of funds should permit us to meet cash obligations and off-balance sheet commitments as they come due.

INVESTMENTS

Our investment portfolio increased by $5.9 million or 5.9% in 2003 as compared to a decrease of $12.9 million in 2002. Our investment portfolio has increased primarily as a result of a $22 million investment purchase that occurred in December 2003 related to a leveraged transaction. We continued to experience significant cash flow from our mortgage-backed securities monthly principal repayments, which averaged $3,730,000 per month. This, along with the sale of some mortgage-backed securities, and the call of some municipal bonds throughout 2003, allowed excess funds to be used for our continued loan growth.

During 2003 new investments were made primarily in short-term mortgage-backed securities. Our current investment strategy is to reinvest in short-term mortgage-backed securities as funds become available.

The following table shows the year-end composition of the investment portfolio for the five years ending December 31:

	Estimated Fair Market Value at December 31,									
	2003 Amount	**% of Total**	2002 Amount	% of Total	2001 Amount	% of Total	2000 Amount	% of Total	1999 Amount	% of Total
Available-for-sale:										
U. S. Treasury securities	**$ -**	**-**	$ -	-	$ -	-	$ 8,655	8.8	$ 13,628	15.1
U. S. Agency securities	**1,033**	**1.0**	1,052	1.0	-	-	1,531	1.6	-	-
Obligations of state & political subdivisions	**8,303**	**7.8**	12,731	12.6	18,543	16.3	20,592	21.0	19,469	21.6
Corporate obligations	**14,674**	**13.8**	21,156	21.0	12,200	10.7	19,710	20.1	18,629	20.7
Mortgage-backed securities	**78,376**	**73.5**	60,801	60.4	77,211	68.0	38,473	39.3	34,045	37.8
Other equity securities	**4,201**	**3.9**	4,985	4.9	5,650	5.0	9,023	9.2	4,260	4.7
Total	**$ 106,587**	**100.0**	$ 100,725	100.0	$ 113,604	100.0	$ 97,984	100.0	$ 90,031	100.0

The expected principal repayments (amortized cost) and average weighted yields for the investment portfolio as of December 31, 2003, are shown below. Expected maturities, which include prepayment speed assumptions for mortgage-back securities, are significantly different than the contractual maturities detailed in Footnote 3 of the Consolidated Financial Statements. Yields on tax-exempt securities are presented on a fully taxable equivalent basis, assuming a 34% tax rate.

	Within One Year	Yield (%)	One-Five Years	Yield (%)	Five-Ten Years	Yield (%)	After Ten Years	Yield (%)	Amortized Cost Total	Yield (%)
Available-for-sale securities:										
U.S. Agency securities	$ -		$ 1,005	4.0	$ -		$ -		$ 1,005	4.0
Obligations of state & political subdivisions	4,035	6.4	3,547	7.0	429	6.4	-	-	8,011	6.7
Corporate obligations	-	-	11,705	5.5	1,951	7.2	-	-	13,656	5.8
Mortgage-backed securities	1,703	5.3	70,308	4.3	6,069	3.9	-	-	78,080	4.3
Equity securities	-	-	4,387	5.9	-	-	-	-	4,387	5.9
Total available-for-sale	$ 5,738	6.1	$ 90,952	4.6	$ 8,449	4.8	$ -	-	$ 105,139	4.7

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Approximately 92% of the amortized cost of debt securities is expected to mature within five years or less.
Our Company expects that earnings from operations, the high liquidity level of the available-for-sale securities, growth of deposits and the availability of borrowings from the Federal Home Loan Bank will be sufficient to meet future liquidity needs.
Our Company has no securities from a single issuer representing more than 10% of stockholders equity.

LOANS

Historically, our Company s loan customers have been located in North Central Pennsylvania and the Southern Tier of New York. We originate loans primarily through direct loans to our existing customer base, with new customers generated by referrals from real estate brokers, building contractors, attorneys, accountants and existing customers. We also do a limited amount of indirect loans through new and used car dealers in our primary lending area.
All lending is governed by a lending policy that is developed and maintained by us and approved by the Board of Directors. Our Company s real estate loan lending policy generally permits the Bank to lend up to 80% of the appraised value or purchase price (whichever is lower) on owner-occupied residential property, when secured by the first mortgage on the property. Home equity lines of credit or second mortgage loans are generally originated subject to maximum mortgage liens against the property of 80% of the current appraised value. The maximum term for mortgage loans is 25 years for one- to four-family residential property and 20 years for commercial and vacation property.
As shown in the following table, total loans grew by $19.2 million in 2003, or 6.4%. In addition, $22.4 million in conforming mortgage loans were originated and $23.8 million sold in the secondary market through Freddie Mac, providing over $349,000 of income in origination fees and premiums on loans sold, compared to $11.9 million in loans originated and $185,000 of income in 2002. The increased activity in loans sold was primarily a result of the conducive interest rate environment that continued during 2003. Residential mortgage lending is a principal business activity and one we expect to continue.
Our Company focuses its commercial lending activity on small businesses and our commercial lending officers have attracted new business loans, especially loans to state and political subdivisions.
The majority of lending activity has been mortgage loans secured by one- to four-family residential property. As of December 31, 2003, residential real estate and real estate construction loans were 58.6% of our total loan portfolio.
Continuing in 2004, our Company s primary goal is to be the premier mortgage lender in our market area, with our menu of conforming mortgages (including "jumbo" and low- to moderate-income homebuyer mortgages) through

Farmers Home Administration (FmHA). The local economy has started to improve slightly and the average unemployment rate has recently been approximately 5.2% (slightly higher than the state unemployment rate of 4.6%) down from 5.9% in 2002. Loan demand has continued during the last quarter of 2003 for residential mortgages and commercial loans. We believe that our continued emphasis on training branch office personnel and the focus on flexibility and fast "turn around time" will continue to aid in growing our loan portfolio. (Also see the discussion in Footnote 4 of the Consolidated Financial Statements.)

Five Year Breakdown of Loans by Type
December 31,

	2003		2002		2001		2000		1999	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Real estate:										
Residential	**$ 180,333**	**56.8**	$ 175,323	58.7	$ 160,439	59.0	$ 151,782	57.7	$ 139,518	60.3
Commercial	**57,370**	**18.1**	47,210	15.8	43,174	15.9	40,044	15.2	32,159	13.9
Agricultural	**7,594**	**2.4**	9,844	3.3	12,169	4.5	12,075	4.6	9,392	4.1
Construction	**5,784**	**1.8**	5,009	1.7	3,219	1.2	3,112	1.2	4,359	1.9
Loans to individuals for household, family and other purchases	**13,145**	**4.1**	13,915	4.7	14,694	5.4	15,020	5.7	15,540	6.7
Commercial and other loans	**16,219**	**5.1**	18,564	6.2	15,099	5.6	17,509	6.7	12,313	5.3
State & political subdivision loans	**37,212**	**11.7**	28,592	9.6	22,920	8.4	23,444	8.9	18,148	7.8
Total loans	**317,657**	**100.0**	298,457	100.0	271,714	100.0	262,986	100.0	231,429	100.0
Less allowance for loan losses	**3,620**		3,621		3,250		2,777		2,270	
Net loans	**$ 314,037**		$ 294,836		$ 268,464		$ 260,209		$ 229,159	

	2003/2002 Change Amount	%	2002/2001 Change Amount	%
Real estate:				
Residential	$ 5,010	2.9	$ 14,884	9.3
Commercial	10,160	21.5	4,036	9.3
Agricultural	(2,250)	(22.9)	(2,325)	(19.1)
Construction	775	15.5	1,790	55.6
Loans to individuals for household, family and other purchases	(770)	(5.5)	(779)	(5.3)
Commercial and other loans	(2,345)	(12.6)	3,465	22.9
State & political subdivision loans	8,620	30.1	5,672	24.7
Total loans	$ 19,200	6.4	$ 26,743	9.8

The following table shows the maturity of state and political subdivision loans, commercial and agricultural loans and commercial loans secured by real estate as of December 31, 2003, classified according to the sensitivity to changes in interest rates within various time intervals:

	Commercial, municipal, agricultural	Real estate construction	Total
Maturity of loans:			
One year or less	$ 9,367	$ -	$ 9,367
Over one year but less than five years	14,903	-	14,903
Over five years	94,125	5,784	99,909
Total	$ 118,395	$ 5,784	$ 124,179
Sensitivity of loans to changes in interest rates - loans due after one year:			
Predetermined interest rate	$ 18,451	$ 782	$ 19,233
Floating or adjustable interest rate	90,577	5,002	95,579
Total	$ 109,028	$ 5,784	$ 114,812

LOAN QUALITY AND PROVISION FOR LOAN LOSSES

As discussed previously, the loan portfolio contains a large portion of real estate secured loans (generally residential home mortgages, mortgages on small business properties, etc.), consumer installment loans and other commercial loans. Footnote 4 of the Consolidated Financial Statements provides further details on the composition of the loan portfolio.

The following table indicates the level of non-performing assets over the past five years ending December 31:

	2003	2002	2001	2000	1999
Non-performing loans:					
Non-accruing loans	**$ 578**	$ 1,064	$ 985	$ 488	$ 421
Impaired loans	**1,926**	1,916	1,077	199	1,334
Accrual loans - 90 days or more past due	**185**	39	111	39	78
Total non-performing loans	**2,689**	3,019	2,173	726	1,833
Foreclosed assets held for sale	**305**	221	408	508	573
Total non-performing assets	**$ 2,994**	$ 3,240	$ 2,581	$ 1,234	$ 2,406
Non-performing loans as a percent of loans net of unearned income	**0.85%**	1.01%	0.80%	0.28%	0.79%
Non-performing assets as a percent of loans net of unearned income	**0.94%**	1.09%	0.95%	0.47%	1.04%

Other than those disclosed above, we do not believe there are any loans classified for regulatory purposes as loss, doubtful, substandard, special mention or otherwise, which will result in losses or have a material impact on future operations, liquidity or capital reserves. We are not aware of any other information that causes us to have serious doubts as to the ability of borrowers in general to comply with repayment terms.

The following table presents an analysis of the allowance for loan losses for the five years ending December 31:

Summary of Loan Loss Experience

	2003	2002	2001	2000	1999
Balance at beginning of period	**$ 3,621**	$ 3,250	$ 2,777	$ 2,270	$ 2,292
Charge-offs:					
Real estate-mortgage	**68**	59	19	86	73
Loans to individuals for household, family and other purchases	**140**	90	109	50	93
Commercial and other loans	**344**	30	19	22	385

Total loans charged-off	**552**	179	147	158	551
Recoveries:					
Real estate-mortgage	**33**	14	1	24	1
Loans to individuals for household, family and other purchases	**63**	34	20	26	38
Commercial and other loans	**20**	67	154	5	15
Total loans recovered	**116**	115	175	55	54
Net loans charged-off (recovered)	**436**	64	(28)	103	497
Provision charged to expense	**435**	435	445	610	475
Balance at end of year	**$ 3,620**	$ 3,621	$ 3,250	$ 2,777	$ 2,270
Loans outstanding at end of year	**$ 317,657**	$ 298,457	$ 271,714	$ 262,986	$ 231,429
Average loans outstanding, net	**$ 306,776**	$ 285,241	$ 266,116	$ 241,359	$ 217,265
Net charge-offs to average loans	**0.14%**	0.02%	-0.01%	0.04%	0.23%
Year-end allowance to total loans	**1.14%**	1.21%	1.20%	1.06%	0.98%
Year-end allowance to total non-performing loans	**134.62%**	119.94%	149.56%	382.51%	123.84%

As detailed in Footnote 4 of the Consolidated Financial Statements and the above tables, total past due (90 days or more) and non-performing loans decreased 11% from December 31, 2002 to December 31, 2003. Charged-off commercial and other loans increased $314,000 during 2003. The increase is the result of a $302,000 loan charged-off during the third quarter, which was the result of a single borrower going into bankruptcy. Overall, in 2003, Northern Tier area development corporations saw a decrease in unemployment, and property values have been stable to slightly increasing. The majority of our loan volume is well collateralized by real estate.

ALLOWANCE FOR LOAN LOSSES

The allowance is maintained at a level, which in management s judgment is adequate to absorb probable future loan losses inherent in the loan portfolio. The amount of the allowance is determined by a formal analysis of delinquencies, large problem credits, non-accrual loans, local economic conditions, trends in the loan portfolio and historic and projected losses. As part of this evaluation, the loan portfolio is divided into several categories in order to improve the analysis. These categories are loans classified on the Watch List, residential mortgages, commercial and consumer loans.

Historical loss factors are calculated for consumer, residential mortgage, and commercial loans for the past seven years. The 5 year average historical loss factor for each category is applied to the performing portion of the loan category. For Watch List loans, the losses are calculated using regulatory guidelines and are based on historical losses. These historical factors, for both the Watch List and homogeneous loan pools, are adjusted based on the five following qualitative factors:

- Level of Delinquencies and Non-Accruals
- Trends in Volume and Terms of Loans
- Experience, Ability and Depth of Management

- National and Local Economic Trends and Conditions
- Concentration of Credit

While we evaluate all of this information quarterly, future adjustments to the allowance may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. In addition, various regulatory agencies, as an integral part of their examination process, review our Company s allowance for loan losses. These agencies may require us to recognize additions to the allowance based on their evaluation of information available to them. We believe that the current allowance is adequate to offset any exposure that may exist for loans that are under secured or loans that might not be collectible.

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

BANK OWNED LIFE INSURANCE

During the third quarter of 2003 the Company elected to purchase $7,000,000 of bank owned life insurance to offset future employee benefit costs. The use of life insurance policies will provide the bank with an asset that will generate earnings to partially offset the current costs of benefits, and eventually (at the death of the insureds) provide partial recovery of cash outflows associated with the benefits.

ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

The allocation of the allowance for loan losses is our determination of the amounts necessary for concentrations and changes in mix and volume of the loan portfolio.

The unallocated portion of the allowance is based upon our assessment of general and specific economic conditions within our market. This allocation is more uncertain and considers risk factors that may not be reflected in our historical loss factors. Total charge-offs for 2004 are expected to return back to their moderate historic levels.

The following table shows the distribution of the allowance for loan losses and the percentage of loans compared to total loans by loan category:

	2003		2002		2001		2000		1999	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount%	%
Real estate loans:										
Residential	**$ 368**	**56.8**	$ 347	58.7	$ 252	59.0	$ 294	57.7	$ 232	60.3
Commercial, agricultural	**1,742**	**20.5**	1,947	19.1	1,689	20.4	1,269	19.8	1,190	18.0
Construction	**-**	**1.8**	6	1.7	-	1.2	-	1.2	-	1.9
Loans to individuals										
for household,										
family and other purchases	**492**	**4.1**	471	4.7	402	5.4	367	5.7	313	6.7
Commercial and other loans	**445**	**5.1**	537	6.2	542	5.6	488	6.7	350	5.3
State & political subdivision loans	**15**	**11.7**	26	9.6	21	8.4	21	8.9	15	7.8
Unallocated	**558**	**N/A**	287	N/A	344	N/A	338	N/A	170	N/A
Total allowance for loan losses	**$ 3,620**	**100.0**	$ 3,621	100.0	$ 3,250	100.0	$ 2,777	100.0	$ 2,270	100.0

DEPOSITS

Traditional deposits continue to be the most significant source of funds for the Company. We are one of the only banks within our market to pay interest on a senior checking product and the only bank that does not require a minimum balance to do so. Larger deposit relationships are rewarded with higher interest rates on our Money Market Investor accounts and Certificates of Deposits.

In addition to a competitive interest rate, the introduction of three new Certificates of Deposit, the Easy-Access CD and the Hassle-Free CD in 2001 and the 36-month step-up CD in 2003 have helped us retain existing CD deposit relationships and attract new ones. Continuous emphasis on personal quality service also plays a large role in our ability to retain existing customers. One of our strategies for growth is to obtain a greater share of wallet from our existing deposit and loan customers. We plan to continue our focus on existing customer growth in 2004.

The Company experienced moderate deposit growth in 2003 of $12.6 million or 3.4%. The table below shows that non-interest bearing deposits increased $6.7 million at December 31, 2003, while savings and NOW accounts increased $3.9 million and $5.8 million, respectively, in 2003. Money market funds decreased by $3.6 million in 2003, as state & political balances decreased throughout the latter half of 2003, as a direct result of the Pennsylvania budget impasse, which was subsequently settled in the fourth quarter.

	2003		2002		2001	
	Amount	**%**	Amount	%	Amount	%
Non-interest-bearing deposits	**$ 46,820**	**12.1**	$ 40,143	10.8	$ 37,361	11.5
NOW accounts	**57,101**	**14.8**	51,304	13.8	51,259	13.8
Savings deposits	**37,629**	**9.8**	33,683	9.0	32,112	8.7
Money market deposit accounts	**42,582**	**11.0**	46,134	12.4	50,458	13.6
Certificates of deposit	**201,559**	**52.3**	201,787	54.1	199,284	53.8
Total	**$ 385,691**	**100.0**	$ 373,051	100.0	$ 370,474	101.4

	2003/2002 Change		2002/2001 Change	
	Amount	**%**	Amount	%
Non-interest-bearing deposits	**$ 6,677**	**16.6**	$ 2,782	7.4
NOW accounts	**5,797**	**11.3**	45	0.1
Savings deposits	**3,946**	**11.7**	1,571	4.9
Money market deposit accounts	**(3,552)**	**(7.7)**	(4,324)	(8.6)
Certificates of deposit	**(228)**	**(0.1)**	2,503	1.3
Total	**$ 12,640**	**3.4**	$ 2,577	0.7

Remaining maturities of certificates of deposit of $100,000 or more:

	2003	2002	2001
3 months or less	**$ 4,179**	$ 4,674	$ 9,557
3 through 6 months	**3,157**	2,559	8,523
6 through 12 months	**5,437**	4,819	3,866
Over 12 months	**28,589**	23,619	12,045
Total	**$ 41,362**	$ 35,671	$ 33,991
As a percent of total certificates of deposit	**20.52%**	17.68%	17.06%

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Deposits by Type of Depositor:

	2003		2002		2001	
	Amount	**%**	Amount	%	Amount	%
Individual, partnerships & corporations	**$ 349,709**	**90.7**	$ 338,079	90.6	$ 332,547	89.8
United States government	**946**	**0.2**	160	0.0	155	0.0
State & political subdivisions	32,289	8.4	32,366	8.7	35,381	9.6
Other	**2,747**	**0.7**	2,446	0.7	2,391	0.6
Total	**$ 385,691**	**100.0**	$ 373,051	100.0	$ 370,474	100.0

We have retained and acquired deposits through new product introductions and competitive pricing, increased marketing efforts, continuous, proactive one-to-one contact from consumer and business customer contact associates, as well as expanded trust and investment management services.

Our wide range of delivery channels provides our customers with convenient options to satisfy their banking needs. This includes Saturday office hours, increased focus on the supermarket branches as full service offices, a network of 17 ATMs, which are part of the STAR network, MasterMoney Debit Card for purchases, Bank-by-Phone and Internet Banking.

BORROWED FUNDS

Borrowed funds increased $10.8 million during the twelve months ending December 31, 2003, primarily due to a $15 million leveraged strategy implemented in December 2003 along with current funding needs required at the end of the year. The Company s daily cash requirements for short-term investments are met by using the financial instruments available through the Federal Home Loan Bank.

In November 2000, the Company borrowed $2 million to invest in the bank subsidiary. This action increased the Bank s capital and improved the negative impact on the regulatory capital ratios as a result of the branches acquired in 2001 (approximately $9.7 million in goodwill). On February 11, 2003 the Company paid off the $2 million loan, which was funded by an operating dividend of $1.75 million from the Bank. The Bank and Company remained well capitalized for regulatory purposes.

In September 2003, the Company borrowed $1.1 million from its line of credit with an unrelated financial institution to buy back 41,800 shares of treasury stock from an estate.

NOTES PAYABLE

In December 2003, the Company formed a special purpose entity, Citizens Financial Statutory Trust I ("the Entity"), to issue $7,500,000 of floating rate obligated mandatory redeemable securities as part of a pooled offering. The rate is determined quarterly and floats based on the 3 month LIBOR plus 2.80%. At December 31, 2003, the rate was 3.97%. The Entity may redeem them, in whole or in part, at face value after December 17, 2008. The Company borrowed the proceeds of the issuance from the Entity in December 2003 in the form of a $7,500,000 note payable, which is included in the liabilities section of the Company s balance sheet. Debt issue costs of $75,000 have been capitalized and are being amortized through the first call date.

Under current accounting rules, the Company s minority interest in the Entity was recorded at the initial investment amount and is included in the other assets section of the balance sheet. The Entity is not consolidated as part of the Company s consolidated financial statements.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

STOCKHOLDERS EQUITY

We evaluate stockholders equity in relation to total assets and the risk associated with those assets. The greater the capital resources, the more likely a corporation is to meet its cash obligations and absorb unforeseen losses. For these reasons, capital adequacy has been, and will continue to be, of paramount importance.

Stockholders equity increased by .32% in 2003 to $38.5 million, after increasing 15.0% in 2002 and increasing 9.5% in 2001. In 2003, we realized an decrease of $1,597,000, compared to 2002 when equity was positively impacted by $1,340,000 to reflect unrealized holding gains and losses on available-for-sale securities. In comparison, in 2001, equity increased $869,000 as a direct result of the change in interest rates. Total equity was approximately 8.3% of total assets at December 31, 2003, as compared to 8.9% at December 31, 2002.

Our Board of Directors determines our dividend rate after considering our Company s capital requirements, current and projected net income, and other factors. In 2003 and 2002, our Company paid out 43.1% and 34.3% of net income in dividends, respectively.

For the year ended December 31, 2003, the total number of common shares outstanding was 2,812,887. For comparative purposes, outstanding shares for prior periods were adjusted for the 2003 stock dividend in computing earnings and cash dividends per share.

There are currently three federal regulatory measures of capital adequacy. Our Company s ratios meet the regulatory standards for well capitalized for 2003 and 2002, as detailed in Footnote 11 of the Consolidated Financial Statements.

RESULTS OF OPERATIONS

Net income for the twelve months ending December 31, 2003 was $4.9 million, a decrease of $716,000 or 12.8% from the $5.6 million for the 2002 related period. Net income for the twelve months ending December 31, 2002 increased $1,838,000 or 48.9% from the $3.8 million for the 2001 related period. Earnings per share were $1.72, $1.96 and $1.32 for the years ended 2003, 2002 and 2001, respectively. The reasons for these changes are discussed on the following pages.

The following table sets forth certain performance ratios of our Company for the periods indicated:

	2003	2002	2001
Return on Assets (net income to average total assets)	**1.11%**	1.30%	0.90%
Return on Equity (net income to average total equity)	**13.22%**	16.53%	12.10%
Dividend Payout Ratio (dividends declared divided by net income)	**43.10%**	34.27%	47.54%
Equity to Asset Ratio (average equity to average total assets)	**8.43%**	7.94%	7.43%

OVERVIEW OF THE INCOME STATEMENT

In 2003, net income was $4,879,000, a decrease of 12.8% compared to 2002 net income of $5,595,000. The decrease in earnings is the result of stable net interest income from the use of increased earning assets, slightly deteriorating margin and improved non-interest income and increase in non-interest expense.

Net income is influenced by five key components: net interest income, non-interest income, non-interest expenses, provision for income taxes and the provision for loan losses. A discussion of these five components follows.

NET INTEREST INCOME

The most significant source of revenue is net interest income; the amount of interest earned on interest-earning assets exceeding interest incurred on interest-bearing liabilities.

Factors that influence net interest income are changes in volume of interest-earning assets and interest-bearing liabilities as well as changes in the associated interest rates.
Net interest income for 2003, after provision for loan losses, was $16,354,000, a decrease of $184,000 or 1.1% compared with an increase of $2,264,000 during the same period in 2002.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following tables set forth our Company s average balances of, and the interest earned or incurred on, each principal category of assets, liabilities and stockholders equity, the related rates, net interest income and rate "spread" created:

Analysis of Average Balances and Interest Rates (1)

	2003			2002			2001		
	Average Balance (1)	**Interest**	**Average Rate**	Average Balance (1)	Interest	Average Rate	Average Balance (1)	Interest	Average Rate
	$	**$**	**%**	$	$	%	$	$	%
ASSETS									
Short-term investments:									
Interest-bearing deposits at banks	**2,987**	**29**	**0.97**	4,174	65	1.56	13,944	547	3.92
Total short-term investments	**2,987**	**29**	**0.97**	4,174	65	1.56	13,944	547	3.92
Investment securities:									
Taxable	**82,048**	**3,633**	**4.43**	91,915	5,169	5.62	85,570	5,553	6.49
Tax-exempt (3)	**10,251**	**693**	**6.76**	14,016	960	6.85	18,858	1,292	6.85
Total investment securities	**92,299**	**4,326**	**4.69**	105,931	6,129	5.79	104,428	6,845	6.55
Loans:									
Residential mortgage loans	**181,602**	**13,199**	**7.27**	172,638	13,373	7.75	160,022	13,432	8.39
Commercial & farm loans	**77,584**	**5,777**	**7.45**	72,230	5,683	7.87	68,708	6,088	8.86
Loans to state & political subdivisions	**34,934**	**2,193**	**6.28**	26,698	1,847	6.92	22,906	1,760	7.68
Other loans	**12,656**	**1,151**	**9.09**	13,675	1,305	9.54	14,480	1,472	10.17
Loans, net of discount (2)(3)(4)	**306,776**	**22,320**	**7.28**	285,241	22,208	7.79	266,116	22,752	8.55
Total interest-earning assets	**402,062**	**26,675**	**6.63**	395,346	28,402	7.18	384,488	30,144	7.84
Cash and due from banks	**9,401**			9,310			9,912		
Bank premises and equipment	**10,967**			11,613			11,281		
Other assets	**15,405**			10,187			12,260		

Total non-interest earning assets	**35,773**			31,110			33,453		
Total assets	**437,835**			426,456			417,941		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Interest-bearing liabilities:									
NOW accounts	**55,195**	**212**	**0.38**	51,851	284	0.55	48,407	561	1.16
Savings accounts	**36,314**	**124**	**0.34**	34,345	164	0.48	32,560	310	0.95
Money market accounts	**47,065**	**493**	**1.05**	49,494	789	1.59	52,879	1,743	3.30
Certificates of deposit	**203,092**	**7,672**	**3.78**	200,485	8,775	4.38	201,656	11,225	5.57
Total interest-bearing deposits	**341,666**	**8,501**	**2.49**	336,175	10,012	2.98	335,502	13,839	4.12
Other borrowed funds	**14,286**	**325**	**2.27**	14,449	392	2.71	10,185	467	4.59
Total interest-bearing liabilities	**355,952**	**8,826**	**2.48**	350,624	10,404	2.97	345,687	14,306	4.14
Demand deposits	**41,266**			38,272			36,241		
Other liabilities	**3,707**			3,703			4,953		
Total non-interest-bearing liabilities	**44,973**			41,975			41,194		
Stockholders' equity	**36,910**			33,857			31,060		
Total liabilities & stockholders' equity	**437,835**			426,456			417,941		
Net interest income		**17,849**			17,998			15,838	
Net interest spread (5)			**4.16%**			4.22%			3.70%
Net interest income as a percentage of average interest-earning assets			**4.44%**			4.55%			4.12%
Ratio of interest-earning assets to interest-bearing liabilities			**1.13**			1.13			1.11

(1) Averages are based on daily averages.
(2) Includes loan origination and commitment fees.
(3) Tax exempt interest revenue is shown on a tax equivalent basis for proper comparison using a statutory federal income tax rate of 34%.
(4) Income on non-accrual loans is accounted for on a cash basis, and the loan balances are included in interest-earning assets.

(5) Interest rate spread represents the difference between the average rate earned on interest-earning assets
and the average rate paid on interest-bearing liabilities.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

As disclosed in the previous table, we continued to experience an attractive interest margin percentage during 2003; however our margin is starting to narrow as compared to the same time period in 2002, and still significantly higher than the narrowing margin that we had experienced in 2001 and prior. Currently, the yield curve is extremely steep beyond 3 months. Most of the Company s investments, loans, deposits and borrowings are priced or repriced along the three month to five-year portion of the yield curve and a more normal yield curve should enable us to maintain our current favorable net interest margin. We continue to review various pricing and investment strategies to enhance deposit growth, while maintaining or expanding the current interest margin.
The following table shows the effect of changes in volume and rates on interest income and expense. Tax-exempt interest revenue is shown on a tax-equivalent basis for proper comparison using a statutory federal income tax rate of 34%.

Analysis of Changes in Net Interest Income on a Tax-Equivalent Basis (1)

	2003 vs. 2002 (1)			2002 vs. 2001 (1)		
	Change in Volume	**Change in Rate**	**Total Change**	Change in Volume	Change in Rate	Total Change
Interest Income:						
Short-term investments:						
Interest-bearing deposits at banks	**$ (40)**	**$ 4**	**$ (36)**	$ 1,286	$ (1,768)	$ (482)
Investment securities:						
Taxable	**(675)**	**(861)**	**(1,536)**	392	(776)	(384)
Tax-exempt	**(255)**	**(12)**	**(267)**	(332)	-	(332)
Total investments	**(930)**	**(873)**	**(1,803)**	60	(776)	(716)
Loans:						
Residential mortgage loans	**675**	**(849)**	**(174)**	1,018	(1,077)	(59)
Commercial & farm loans	**409**	**(315)**	**94**	301	(706)	(405)
Loans to state & political subdivisions	**529**	**(183)**	**346**	273	(186)	87
Other loans	**(85)**	**(69)**	**(154)**	(133)	(34)	(167)
Total loans, net of discount	**1,528**	**(1,416)**	**112**	1,459	(2,003)	(544)
Total Interest Income	**558**	**(2,285)**	**(1,727)**	2,805	(4,547)	(1,742)

Interest Expense:						
Interest-bearing deposits:						
NOW accounts	**17**	**(89)**	**(72)**	38	(315)	(277)
Savings accounts	**10**	**(50)**	**(40)**	16	(162)	(146)
Money Market accounts	**(40)**	**(256)**	**(296)**	(120)	(834)	(954)
Certificates of deposit	**113**	**(1,216)**	**(1,103)**	(65)	(2,385)	(2,450)
Total interest-bearing deposits	**100**	**(1,611)**	**(1,511)**	(131)	(3,696)	(3,827)
Other borrowed funds	**(5)**	**(62)**	**(67)**	155	(230)	(75)
Total interest expense	**95**	**(1,673)**	**(1,578)**	24	(3,926)	(3,902)
Net interest income	**$ 463**	**$ (612)**	**$ (149)**	$ 2,781	$ (621)	$ 2,160

(1) The change in interest due to both rate and volume has been allocated to the volume and rate in proportion to the absolute dollar amounts of each change.

As can be seen from the preceding tables, tax equivalent net interest income rose from $15,838,000 in 2001 to $17,998,000 in 2002, and decreased to $17,849,000 in 2003. In 2003, net interest income decreased $149,000 while overall spread decreased from 4.22% to 4.16%. The increased volume of interest-earning assets generated an increase in interest income of $558,000 while increased volume of interest-bearing liabilities produced $95,000 of interest expense. The change in volume resulted in a net increase of $463,000 in net interest income. The net change in rate was a negative $612,000 resulting in a total negative net change of $149,000 when combined with change in volume. The yield on interest-earning assets declined 55 basis points from 7.18% to 6.63% and the average interest rate on interest-bearing liabilities declined 49 basis points from 2.97% to 2.48%. Analysis of our Company s net interest income in 2002 and 2003 shows the effects of declining short-term interest rates and the effect of the steepening of the yield curve.

During 2003, the Federal Reserve reduced short-term interest rates by 25 basis points in the second quarter. We expect the 2003 Federal Reserve rate reduction to continue to help us maintain our current net interest margin during the first half of 2004. We continue to evaluate alternatives to improve or sustain the interest spread.

NON-INTEREST INCOME

Non-interest income, as detailed below, increased $266,000 or 5.3% in 2003 compared to a $757,000 increase in 2002. Service charge income, which decreased $112,000 or 3.6% in 2003, continues to be the primary source of non-interest income. Other income decreased $145,000 or 15.8% in 2003. This decrease is due to a decrease of $209,000 in the life and accident/health insurance reimbursement account, a $48,000 insurance claim being received in 2002, along with $57,000 decrease on the sale of foreclosed property. The decreases were somewhat offset by income of $142,000 from the Company s investment in bank owned life insurance. Gains on loans sold increased $164,000 associated with the previously mentioned loans sold on the secondary market.

The following table reflects non-interest income by major category for the periods ended December 31:

	2003	2002	2001
Service charges	$ 3,018	$ 3,130	$ 2,527
Trust	622	562	578
Gains on loans sold	349	185	31
Realized securities gains, net	553	254	657
Other	770	915	496
Total	$ 5,312	$ 5,046	$ 4,289

	2003/2002 Change		2002/2001 Change	
	Amount	%	Amount	%
Service charges	$ (112)	(3.6)	$ 603	23.9
Trust	60	10.7	(16)	(2.8)
Gains on loans sold	164	88.6	154	496.8
Realized securities gains, net	299	117.7	(403)	(61.3)
Other	(145)	(15.8)	419	84.5
Total	$ 266	5.3	$ 757	17.6

We continue to evaluate additional means of increasing non-interest income. Our approach is to apply service charges on business accounts by charging fees on transaction activity (reduced by earnings credit based on customers balances) to more equitably recover costs.
In an effort to take advantage of current market conditions, we elected to sell and reinvest approximately $12,108,000 of investment securities in 2003, which resulted in $553,000 of security gains.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NON-INTEREST EXPENSES

The costs associated with operating the Company rose by 9.0% to $15,501,000 during 2003 compared to $14,226,000 in 2002. These costs include but were not limited to salaries, supplies, insurance, occupancy, and amortization expenses. The large increase in salaries and employee benefits is the result of a consulting and non-compete agreement entered into in the third quarter with Richard E. Wilber, President and CEO, which was effective upon Mr. Wilber s retirement. The financial impact of this agreement is an increase to salaries and benefits of $824,000 for the year ended December 31, 2003. The additional increase of $360,000 is the result of filling some corporate positions related to the growth strategies that we have implemented, along with annual salary increases and adjustments combined with a reduction of $358,000 on our anticipated profit sharing expense. Also included in the increase for salaries and employee benefits is an increase of $180,000 in pension expense as a result of current obligations and market performance. The decrease in furniture and equipment is a direct result of depreciation run-off that has occurred. Amortization expense decreased in 2002 as a result of the adoption of FAS No. 142 that was previously discussed (see footnote 14).

The following tables reflect the breakdown of non-interest expense and professional fees for the periods ended December 31:

	2003	2002	2001
Salaries and employee benefits	**$ 8,304**	$ 7,120	$ 6,597
Occupancy	**1,025**	998	992
Furniture and equipment	**713**	881	966
Professional fees	**694**	667	494
Amortization	**435**	457	1,015
Other	**4,330**	4,103	3,977
Total	**$ 15,501**	$ 14,226	$ 14,041

	2003/2002 Change		2002/2001 Change	
	Amount	**%**	Amount	%
Salaries and employee benefits	**$ 1,184**	**16.6**	$ 523	7.9
Occupancy	**27**	**2.7**	6	0.6
Furniture and equipment	**(168)**	**(19.1)**	(85)	(8.8)
Professional fees	**27**	**4.0**	173	35.0
Amortization	**(22)**	**(4.8)**	(558)	(55.0)
Other	**227**	**5.5**	126	3.2
Total	**$ 1,275**	**9.0**	$ 185	1.3

PROFESSIONAL FEES

	2003	2002	2001
Other professional fees	**$ 460**	$ 505	$ 366
Legal fees	**109**	70	43
Examinations and audits	**125**	92	85
Total	**$ 694**	$ 667	$ 494

	2003/2002 Change		2002/2001 Change	
	Amount	**%**	Amount	%
Other professional fees	**$ (45)**	**(8.9)**	$ 139	38.0
Legal fees	**39**	**55.7**	27	62.8
Examinations and audits	**33**	**35.9**	7	8.2
Total	**$ 27**	**4.0**	$ 173	35.0

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The professional fees expense in 2003 reflects costs associated with a workflow process review, which was initiated in the fourth quarter of 2002, along with increased costs associated with examinations and audits due to the decision to outsource our internal audit function during 2003.

PROVISION FOR INCOME TAXES

The provision for income taxes was $1,286,000 during 2003 compared with $1,763,000 during the 2002 related period. Income before taxes decreased $1,193,000 in the 2003 period over the same period in 2002 reflecting the decreased levels of taxable income due primarily to the fore mentioned consulting and non-compete agreement entered into with Richard E. Wilber upon his retirement.

We have entered into two limited partnership agreements to establish low-income housing projects in our market area. As a result of these agreements for tax purposes, we have recognized $297,000 out of a total $911,000 from one project and $77,000 out of a total $385,000 on the second project. A total of approximately $1,290,000 of tax credits is anticipated over a ten-year period.

LIQUIDITY

Liquidity is a measure of our Company s ability to efficiently meet normal cash flow requirements of both borrowers and depositors. To maintain proper liquidity, we use funds management policies along with our investment policies to assure we can meet our financial obligations to depositors, credit customers and stockholders. Liquidity is needed to meet depositors withdrawal demands, extend credit to meet borrowers needs, provide funds for normal operating expenses and cash dividends, and fund other capital expenditures.

Our Company s historical activity in this area can be seen in the Consolidated Statement of Cash Flows from investing and financing activities.

Cash generated by operating activities, investing activities and financing activities influences liquidity management. The most important source of funds is the deposits that are primarily core deposits (deposits from customers with other relationships). Short-term debt from the Federal Home Loan Bank supplements our Company s availability of funds. Another source of short-term liquidity is the sale of loans if needed.

Our Company s use of funds is shown in the investing activity section of the Consolidated Statement of Cash Flows, where the net loan activity is detailed. Other significant uses of funds are capital expenditures, purchase of loans and acquisition premiums. Surplus funds are then invested in investment securities.

Capital expenditures were $490,000 in 2003, $17,000, or 3.6%, more than 2002.

Major capital expenditures for 2003 were:

· Of the $490,000 capital expenditures recognized this year, $151,000 was attributable to an AS400 upgrade and $40,000 for profitability software.

Some major capital expenditures for 2002 were:

· Of the $473,000 capital expenditures recognized this year, $241,000 was attributable to a new roof on the operations facilities and the final implementation of our new document imaging system.

These expenditures will allow us to support our growth over the next decade, create greater operating efficiency and provide the customer with higher quality banking services.

Our Company achieves additional liquidity primarily from temporary or short-term investments in the Federal Home Loan Bank of Pittsburgh, PA, and investments that mature in less than one year. The Company also has a maximum borrowing capacity at the Federal Home Loan Bank of approximately $177 million as an additional source of liquidity.

Apart from those matters described above, management does not currently believe that there are any current trends, events or uncertainties that would have a material impact on capital.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTEREST RATE AND MARKET RISK MANAGEMENT

The objective of interest rate sensitivity management is to maintain an appropriate balance between the stable growth of income and the risks associated with maximizing income through interest sensitivity imbalances and the market value risk of assets and liabilities.

Because of the nature of our operations, we are not subject to foreign currency exchange or commodity price risk and, since our Company has no trading portfolio, it is not subject to trading risk.

Currently our Company has equity securities that represent approximately 4% of our investment portfolio and, therefore, equity risk is not significant.

The primary components of interest-sensitive assets include adjustable-rate loans and investments, loan repayments, investment maturities and money market investments. The primary components of interest-sensitive liabilities include maturing certificates of deposit, IRA certificates of deposit and short-term borrowings. Savings deposits, NOW accounts and money market investor accounts are considered core deposits and are not short-term interest sensitive (except for the top-tier money market investor accounts which are paid current market interest rates).

The following table shows the cumulative static GAP (at amortized cost) for various time intervals:

	Within Three Months	Four to Twelve Months	One to Two Years	Two to Three Years	Three to Five Years	Over Five Years	Total
Interest-earning assets:							
Interest-bearing deposits at banks	$ 327	$ -	$ -	$ -	$ -	$ -	$ 327
Investment securities	7,324	14,534	26,223	26,101	26,144	4,813	105,139
Residential mortgage loans	8,769	22,567	21,088	24,925	28,173	80,595	186,117
Commercial and farm loans	9,995	15,777	15,170	10,211	22,283	7,747	81,183
Loans to state & political subdivisions	3,535	5,211	9,356	7,577	9,044	2,489	37,212
Other loans	2,891	3,156	2,900	1,533	1,433	1,232	13,145
Total interest-earning assets	$ 32,841	$ 61,245	$ 74,737	$ 70,347	$ 87,077	$ 96,876	$ 423,123
Interest-bearing liabilities:							
NOW accounts	$ 12,880	$ -	$ -	$ -	$ -	$ 44,221	$ 57,101
Savings accounts	-	-	-	-	-	37,629	37,629
Money Market accounts	42,582	-	-	-	-	-	42,582
Certificates of deposit	23,459	55,723	44,453	30,384	45,047	2,493	201,559
Short-term borrowing	13,012	-	-	-	-	-	13,012
Long-term borrowing	-	2,435	3,419	8,214	716	-	14,784
Total interest-bearing liabilities	$ 91,933	$ 58,158	$ 47,872	$ 38,598	$ 45,763	$ 84,343	$ 366,667
Excess interest-earning assets (liabilities)	$ (59,092)	$ 3,087	$ 26,865	$ 31,749	$ 41,314	$ 12,533	
Cumulative interest-earning assets	32,841	94,086	168,823	239,170	326,247	423,123	

Cumulative interest-bearing liabilities	91,933	150,091	197,963	236,561	282,324	366,667
Cumulative gap	$ (59,092)	$ (56,005)	$ (29,140)	$ 2,609	$ 43,923	$ 56,456
Cumulative interest rate sensitivity ratio (1)	0.36	0.63	0.85	1.01	1.16	1.15

(1) Cumulative interest-earning assets divided by cumulative interest-bearing liabilities.

The previous table and the simulation models discussed below are presented assuming money market investment accounts and NOW accounts in the top interest rate tier are repriced within the first three months. The loan amounts reflect the principal balances expected to be re-priced as a result of contractual amortization and anticipated early payoffs.

Gap analysis, one of the methods used by us to analyze interest rate risk, does not necessarily show the precise impact of specific interest rate movements on our Company s net interest income because the re-pricing of certain assets and liabilities is discretionary and is subject to competition and other pressures. In addition, assets and liabilities within the same period may, in fact, be repaid at different times and at different rate levels.

Our Company currently uses a computer simulation model to better measure the impact of interest rate changes on net interest income. We use the model as part of our risk management process that will effectively identify, measure, and monitor our Company s risk exposure.

Interest rate simulations using a variety of assumptions are used by us to evaluate our interest rate risk exposure. A shock analysis at December 31, 2003, indicated that a 200 basis point movement in interest rates in either direction would have a minor impact on our Company s anticipated net interest income and the market value of assets and liabilities over the next twenty-four months, well within our ability to manage effectively.

GENERAL

The majority of assets and liabilities of a financial institution are monetary in nature and, therefore, differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. However, inflation does have an important impact on the growth of total assets and on non-interest expenses, which tend to rise during periods of general inflation. The recent action by the Federal Reserve of decreasing short-term interest rates should help the level of inflation to remain at a relatively low level.

Various congressional bills have been passed and other proposals have been made for significant changes to the banking system, including provisions for: limitation on deposit insurance coverage; changing the timing and method financial institutions use to pay for deposit insurance; and tightening the regulation of bank derivatives activities.

Normal examinations of our Company by the Office of Comptroller of the Currency occurred during 2003. The last Community Reinvestment Act performance evaluation by the same agency resulted in a rating of "Outstanding Record of Meeting Community Credit Needs."

Aside from those matters described above, we do not believe that there are any trends, events or uncertainties that would have a material adverse impact on future operating results, liquidity or capital resources. We are not aware of any current recommendations by the regulatory authorities which, if they were to be implemented, would have such an effect, although the general cost of compliance with numerous and multiple federal and state laws and regulations does have, and in the future may have, a negative impact on our Company s results of operations.

CRITICAL ACCOUNTING POLICIES

The Company s accounting policies are integral to understanding the results reported. The accounting policies are described in detail in Note 1 of the consolidated financial statements. Our most complex accounting policies require

management s judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. We have established detailed policies and control procedures that are intended to ensure valuation methods are well controlled and applied consistently from period to period. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. The following is a brief description of our current accounting policies involving significant management valuation judgments.

Other Than Temporary Impairment of Equity Securities

Equity securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management uses criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Allowance for Loan Losses

Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. The Company s allowance for loan losses provides for probable losses based upon evaluations of known, and inherent risks in the loan portfolio.
Management uses historical information to assess the adequacy of the allowance for loan losses as well as the prevailing business environment; as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. The allowance is increased by provisions for loan losses and by recoveries of loans previously charged-off and reduced by loans charged-off. For a full discussion of the Company s methodology of assessing the adequacy of the reserve for loan losses, refer to Note 1 of "Notes to Consolidated Financial Statements."

Goodwill and Other Intangible Assets

As discussed in Note 1 of the consolidated financial statements, the Company must assess goodwill and other intangible assets each year for impairment. This assessment involves estimating cash flows for future periods. If the future cash flows were less than the recorded goodwill and other intangible assets balances, we would be required to take a charge against earnings to write down the assets to the lower value.

Mortgage Servicing Rights

The Bank originates residential mortgages that are sold on the secondary market and it is the Bank s normal practice to retain the servicing of these loans. This means that the customers whose loans have been sold to the secondary market still make their monthly payments to the Bank. As a result of these mortgage loan sales, the Bank capitalizes a value allocated to the servicing rights in other assets and recognizes other income from the mortgage banking activity. The capitalized servicing rights are amortized against noninterest income in proportion to, and over the periods of, the estimated net servicing income of the underlying financial assets.

Capitalized servicing rights are evaluated for impairment periodically based upon the fair value of the rights as compared to amortized cost. The rights are deemed to be impaired when the fair value of the rights is less than the amortized cost. The fair value of the servicing rights is determined using quoted prices for similar assets with similar characteristics, when available, or estimated based on projected discounted cash flows using market based assumptions. The Bank primarily uses the discounted cash flow method.

Deferred Tax Assets

We use an estimate of future earnings to support our position that the benefit of our deferred tax assets will be realized. If future income should prove non-existent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and our net income will be reduced. Our deferred tax assets are described further in Note 9 of the consolidated financial statements.

CONTRACTUAL OBLIGATIONS, COMMITMENTS, AND OFF-BALANCE SHEET ARRANGEMENTS

The Company has various financial obligations, including contractual obligations and commitments, that may require future cash payments.

Contractual Obligations:

The following table presents, as of December 31, 2003, significant contractual obligations to third parties by payment date. Discussion of the obligations can be found in the notes to the consolidated financial statements.

	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Deposits without a stated maturity	$ 184,132	$ -	$ -	$ -	$ 184,132
Certificates of Deposit	79,182	74,837	45,047	2,493	201,559
Borrowed funds	15,445	11,635	716	-	27,796
Notes payable	-	-	7,500	-	7,500
Total	$ 278,759	$ 86,472	$ 53,263	$ 2,493	$ 420,987

Commitments:

The following table presents, as of December 31, 2003, the amounts and expected maturities of significant commitments. Discussion of the obligations can be found in the notes to the consolidated financial statements.

	One Year or Less	One to Three Years	Three to Five Years	Over Five Years	Total
Commitments to extend credit					
Commercial	$ 3,499	$ 103	$ 244	$ 4,172	$ 8,018
Residential real estate	412	109	37	9,332	9,890
Other	10,626	1,265	1,374	9,921	23,186
Standby letters of credit	559	801	44	-	1,404

Total	$ 15,096	$ 2,278	$ 1,699	$ 23,425	$ 42,498

Commitments to extend credit, including loan commitments, standby letters of credit, and commercial letters of credit do not necessarily represent future cash requirements, in that these commitments often expire without being drawn upon.

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Michael J. Yanuzzi
OFFICERS
Timothy C. Hickey, AVP
Debbie L. Lynch

TOWANDA
111 Main Street,
Towanda, PA 18848
570-265-6137
FAX 570-265-7340
LOCAL BOARD
Rinaldo A. DePaola, Chairman
Avery B. Boardman, DO
Jeffrey B. Carr
Thomas R. Horn, DC
Vicki L. Schmidt
OFFICERS
Jeffrey B. Carr, AVP
Lorraine F. Brown
Judy R. Burleigh

WELLSBORO
99 Main Street
Wellsboro, PA 16901
570-724-2600
FAX 570-724-4381
LOCAL BOARD
William S. Hebe, Esq., Chairman
D. Edward Cornell
Timothy J. Gooch, CPA
Marsha B. Jones
James K. Stager
OFFICERS
Marsha B. Jones
Deborah L. Meacham

TROY
Main & Exchange Streets,
Troy, PA 16947
570-297-2131
FAX 570-297-2521
LOCAL BOARD
Donald D. White, PA,, Chairman
Thomas A. Calkins, III
Richard H. Packard
Suzanne S. Putnam
Betsy L. Seeley
OFFICERS

CANTON
29 West Main Street,
Canton, PA 17724
570-673-3103
FAX 570-673-4573
LOCAL BOARD
David L. Wright, Sr., Chairman
Randy L. Castle
Lester E. Hilfiger
Janet E. Holmes
Marilyn I. Scott
OFFICERS
Janet E. Holmes, AVP
Diane S. Slotter

MILLERTON
RR2 Box 41D, Route 328,
Millerton, PA 16936
570-537-2203
FAX 570-537-2400
LOCAL BOARD
Lawrence W. Colunio J
ohn L. Huntington
Helen Kay Shedden
Kathy S. Webster
OFFICER
Kathy S. Webster, AVP

LERAYSVILLE
1 Route 467 & Main Sts,
LeRaysville, PA 18829
570-744-2431
FAX 570-744-2196
LOCAL BOARD
Harrison D. Johnson, Chairman
Debra A. Donnelly
Gerald A. Histand
Louis C. Ugliuzza
Martha D. Young
OFFICER

Suzanne S. Putnam, AVP	Debra A. Donnelly, AVP
Bryan R. Smith	

GILLETT	WEIS MARKET	WAL*MART
PO Box 125,	201 Weis Plaza	2 WalMart Plaza
Gillett, PA 16925	Wellsboro, PA 16901	Mansfield, PA 16933
570-596-2679	570-724-4644	570-662-8520
FAX 570-596-4888	FAX 570-724-1842	FAX 570-662-8525
LOCAL BOARD	OFFICERS	OFFICERS
Lawrence W. Colunio	Jennifer L. Kane	Richard A. Pino, II
John L. Huntington	Nancy M. Stamili	Jill M. Pino
Helen Kay Shedden		
Kathy S. Webster		
OFFICER		
Helen K. Shedden, AVP		

COMPANY INFORMATION

Shareholders Information

ANNUAL MEETING

The Annual Meeting and Luncheon for the shareholders of Citizens Financial Services, Inc. will be held at Tioga County Fairgrounds Youth Building in Whitneyville, PA on Tuesday, April 20, 2004 at 12:00 noon.

FORM 10-K

The Annual Report to the Securities and Exchange Commission and Form 10-K will be made available upon request.

CONTACT:

Thomas C. Lyman, Treasurer

Citizens Financial Services, Inc.

15 South Main Street

Mansfield, PA 16933

INVESTOR INFORMATION

Stock Listing: Citizens Financial Services, Inc. common stock is listed on the over the counter bulletin board and is traded under the symbol CZFS.

For assistance regarding a change in registration of stock certificates, replacing lost certificates/dividend checks, or address changes, please contact the transfer agent listed below.

Transfer Agent:
Citizens Financial Services, Inc.
Attn: Gina Marie Boor
15 South Main Street
Mansfield, PA 16933
toll free: 1-800-326-9486
telephone: 570/662-2121
website: www.firstcitizensbank.com
e-mail: fcnb@firstcitizensbank.com

Dividend Reinvestment: Citizens Financial Services, Inc. offers a Dividend Reinvestment Plan. Shareholders must enroll at least 25 shares to participate in the Plan. Cash dividends are held by our Plan Administrator and used to automatically purchase additional shares of our common stock. You may choose to have all dividends reinvested or a portion. Please contact the Transfer Agent listed for an enrollment form.

Certificate Safekeeping: Stock certificates can be held by our Plan Administrator for safekeeping. Any certificates sent to the Plan Administrator for safekeeping are automatically enrolled in the Dividend Reinvestment Program Please contact the Transfer Agent listed for an enrollment form.
Direct Deposit of Dividends: For shareholders who do not participate in the Dividend Reinvestment Plan, direct deposit of cash dividend payments to a checking or savings account is available. Please contact the Transfer Agent listed for an enrollment form.

Reports: The Annual Report and other Company reports are filed electronically through the Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR") which performs automated collection, validation, indexing, acceptance, and forwarding of submissions to the Securities and Exchange Commission (SEC) and is accessible by the public using the internet at http://www.sec.gov/edgar.htm

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MARKET MAKERS

Ferris, Baker Watts, Inc.
100 Light St., 9th Fl.
Baltimore, MD 21202
Telephone: 410-659-4600

Ryan, Beck & Co.
Head Trader
220 South Orange Avenue

Monroe Securities, Inc.
47 State St., 2nd Fl.
Rochester, NY 14614
Telephone: 800-766-5560

Boenning & Scattergood, Inc.
2 Barr Harbor Dr., Suite 300,

Keefe, Bruyette & Woods, Inc.
787 Seventh Ave., 4th Fl.
New York, NY 10019
Telephone: 212-554-2600

GVR Co. LLC
One Financial Place
440 La Salle St., Ste 3030

Powell (E E) & Co., Inc.
1100 Gulf Tower, 11th Fl.
Pittsburgh, PA 15219
Telephone: 412-391-4594

Pershing Trading Company
One Pershing Plaza
Jersey City, NJ 07399
Telephone: 201-413-3531

Livingston, NJ 07039
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Schwab Capital Markets LP
111 Pavonia Ave., 15th Fl.
Jersey City, NJ 07310
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4 Tower Bridge
W. Conshohocken, PA
19428 Telephone:
610-828-0400

Knight Equity Markets, LP
Newport Tower,
525 Washington Blvd., 30th Fl.
Jersey City, NJ 07310
Telephone: 212-336-8790

Chicago, IL 60605
Telephone: 800-638-8602

Hill Thompson Magid & Co.
15 Exchange Pl., 8th Fl.
Jersey City, NJ 07302
Telephone: 800-631-3083