

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549  
FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934  
for the fiscal year ended December 31, 2006

or

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

Commission File No: 2-96144

CITIZENS FINANCIAL CORP.

(exact name of registrant as specified in its charter)

Delaware  
(State of Incorporation)

55-0666598  
(I.R.S. Employer Identification Number)

213 Third St.  
Elkins, West Virginia  
(Address of Principal  
Executive Offices)

26241  
(Zip Code)

Registrant's Telephone Number,  
Including Area Code:

(304) 636-4095

Securities Registered Pursuant to Section 12(b) of the Act: None

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes

No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes

No

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

Yes

No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Yes

No

Indicate by check mark whether the registrant is a large accelerated filer; an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

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

Yes

No

The aggregate market value of Citizens Financial Corp. common stock, representing all of its voting stock that was held by nonaffiliates as of the last business day of Citizens most recently completed second fiscal quarter, approximated \$29,983,000.

As of March 28, 2007 Citizens Financial Corp. had 1,829,504 shares of common stock outstanding with a par value of \$2.00.

Documents incorporated by reference: **None**

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## Form 10-K, Part I

### Item 1. Business

#### Organizational History and Subsidiaries

Citizens Financial Corp., ("Citizens" or the "company"), is a \$243 million bank holding company providing retail and commercial banking services primarily in central and eastern West Virginia. Citizens was incorporated in the State of Delaware in 1986 and is the parent company and sole owner of Citizens National Bank of Elkins (the "bank").

The bank was organized in West Virginia in 1923, received approval of the Comptroller of the Currency in 1924, and has continuously operated as a national bank headquartered in Elkins, West Virginia since that time. In 1987 the stockholders of the bank approved an Agreement and Plan of Reorganization whereby the bank became a wholly-owned subsidiary of Citizens Financial Corp. Since its formation, the bank has expanded to a six branch network by acquiring the Tucker County Bank in Parsons, West Virginia in 1984 and the Petersburg, West Virginia office of South Branch Valley National Bank in 2000. It also opened branch offices in Beverly, West Virginia in 1992, in Slatyfork, West Virginia in 2000, and in Marlinton, West Virginia in 2002.

#### Business of Citizens and Subsidiary

As a bank holding company, Citizens' operations have been limited to the ownership of its subsidiary. To date, it has not sought to conduct any other form of permitted business activity, nor are there any current plans to do so.

Citizens National Bank, however, provides a wide range of retail and commercial banking services including demand, savings and time deposits; residential, consumer and commercial loans; letters of credit; safe deposit and wire transfer services; and ATM, telebanking and internet banking services. In addition, the bank operates a trust department and has formed relationships which allow it to provide brokerage and financial planning services as well as fixed rate residential mortgages.

In competing with other financial service providers, the bank utilizes selective pricing and marketing strategies but primarily relies on developing personal relationships with customers and providing superior customer service. The bank is heavily involved in local charitable, civic, educational and community development efforts and prides itself on being a responsible corporate citizen.

#### Lending Activities

One of the objectives held by the bank's founders is the granting of loans to creditworthy individuals and businesses, and the bank now provides such services from five of its six offices. In this regard, the bank has developed three primary loan portfolios: real estate, commercial, and consumer. The real estate loan portfolio can be further segmented into four distinct categories: construction, home equity, residential mortgage, and commercial mortgage. Construction loans are typically made for the construction of residential or commercial properties and have short maturity intervals of one year or less. These loans are often times converted to permanent financing and transferred to either the residential or commercial real estate categories. Home equity loans are generally lines of credit issued on residential properties that allow customers to access funds through check writing privileges. Residential mortgage loans are typically made for the purchase or refinancing of single family homes and are usually secured by a first lien deed of trust. In general, these loans do not exceed an 80% loan to value ratio as determined by the use of independent appraisals or evaluations and carry a variable interest rate. Nearly all residential real estate loans are made within the bank's primary market area, and they tend to be in amounts of under \$100,000. Loans, be they for residential real estate or other purposes, which exceed the established lending limit of the loan officer require approval of a superior officer or the directors loan committee. Historically, we have not experienced significant losses in this area, and these loans are viewed among the least risky made by the bank. Nonetheless, these loans, particularly those with larger balances, are subject to periodic review by the bank's loan review officer.

Commercial real estate loans consist of commercial mortgages which are generally secured by nonresidential and multifamily (five or more) residential properties. These loans are typically made to local businesses and are subject to many of the same criteria and controls as residential real estate loans. These loans do tend to be larger than residential real estate loans and usually require approval of the directors' loan committee as a result. Because of their size and higher degree of risk, these loans are usually subject to more extensive credit analysis prior to being made, require the appraisal of the real property collateral, and are subject to periodic reviews by the bank's loan review function.

The commercial loan portfolio consists of loans to local businesses and are secured by liens on accounts receivable, inventory, machinery and equipment, or other business assets. If necessary, personal guarantees of the

business owners, key man life insurance, and other forms of collateral are also required although business cash flow represents the primary source of repayment. These loans are subject to the risks of the borrowers industry. Such industries include auto dealerships, lumbering and lumber related businesses, various tourism and hospitality businesses, and retail and wholesale merchants. Commercial loans are typically among the largest loans made by the bank and are considered to carry a higher level of risk than smaller loans. Underwriting standards require a comprehensive credit analysis, and the appraisal of real property and significant machinery, such as lumbering equipment, held as collateral. We attempt to limit risk by diversifying the commercial loan portfolio within the constraints of our economic market and closely monitoring any concentrations of credit. Periodic credit reviews of commercial loans are performed by the loan review officer.

Due to the limited size of our market area as well as the increased competition for home mortgage and auto loans, we also participate in commercial loans in surrounding markets through a group of community banks similar to ourselves. These loans may be secured by commercial real estate or other business property although the primary source of repayment is from business operations. Because these loans may be outside our primary market area they are subject to extensive analysis including the business and credit history of the borrowers and any guarantors, cash flow and payment abilities, collateral valuations and other pertinent factors. Additional security such as the assignment of life insurance and various loan covenants designed to limit risk are also obtained when necessary. As of December 31, 2006, these loans totaled \$7,710,503 million, or 4.6% of our total loan portfolio.

Consumer loans are made to individuals for the financing of household and personal needs, often the purchase of a car. In such cases, the car is typically held as collateral although the bank does grant unsecured consumer loans usually for small amounts and with significantly higher interest rates than otherwise offered. Cash flow analysis and knowledge of the financial strength and character traits of the borrower are important considerations in granting many consumer loans. When securing consumer loans with cars, the value of the car relative to the loan is a key factor and is determined by auto industry guides. Loan terms on consumer loans are typically three to six years, depending on the type of collateral. Unlike real estate and commercial loans, few consumer loans require loan committee approval or are subject to review by the loan review officer. As a result, risk is closely tied to adherence to proper underwriting procedures and the condition of the local economy.

Our credit policies and procedures are updated periodically and approved by the board of directors annually. These policies and procedures are applied uniformly throughout Citizens' banking network and are designed to ensure credit quality is maintained while meeting the legitimate credit needs of the communities we serve. Adherence to policies is ensured by testing by both the internal auditor and compliance officer. Further information on our lending activities may be found in the Management's Discussion and Analysis portion of this report as well as in the Notes to the accompanying consolidated financial statements.

### Investment Activities

Funds not needed to satisfy loan demand or other operational needs are invested in a portfolio of securities designed to improve earnings, provide liquidity, and balance interest sensitivity concerns. Our investment policy is updated periodically and approved by the board of directors annually. This policy limits securities which may be held to those of the U.S. government or its agencies having maturities of less than ten years; bank qualified, investment grade municipal obligations maturing in less than twenty years; investment grade corporate bonds with maturities of five years or less; and mortgage backed obligations of the federal government having a weighted average life of under 10 years. All purchases, sales and calls of securities, together with municipal and corporate holdings of any single issuer which exceed 10% of capital and any holdings with a credit quality below investment grade, are reported to the board of directors monthly.

The investment portfolio is managed by the company's chief financial officer who meets with the president on a quarterly basis to discuss investment strategies and related liquidity and interest sensitivity issues. Additional information about the company's investing activities is contained in the Management's Discussion and Analysis and in the Notes to the accompanying consolidated financial statements.

### Deposit Functions

Our primary source of funding is provided by our deposit base. We offer a variety of deposit products including demand deposits, savings, and time deposits to customers in our market area to satisfy their saving, investing, and retirement needs. We do not solicit or accept out of market or wholesale deposits, nor do we utilize the services of any deposit brokers. As is the case with our lending activities, some selective pricing and marketing strategies are utilized in an effort to attract and retain deposits, but developing strong customer relationships and providing superior customer service remain central to the bank's success.

### Banking Operations

Operationally, we have centralized administrative and support functions in an attempt to achieve consistency and efficiency. The bank's main office provides services such as bookkeeping, accounting, loan administration and review, compliance, marketing, training and development, human resources, and information technology support. Data processing and internal audit, while administered through the main office, are provided through third parties who are experts in their fields.

### Employees

As of February 28, 2007, Citizens National Bank had a staff of 91 full-time equivalent employees. The bank's employees are not represented by any union or other collective bargaining agreement and employee relations are believed to be good. Citizens Financial Corp. does not have any paid employees.

### Competition

Despite having a generally rural marketplace, Citizens faces a high degree of competition for its services from other banks, savings institutions, credit unions, insurance companies, mutual funds, securities brokers, financial planners, mortgage brokers, credit card companies, and some governmental agencies. We believe our focus on providing superior, personalized services, as well as the ability to offer trust, brokerage, and fixed rate mortgage products, help us prosper within this environment.

We maintain offices in Randolph, Tucker, Grant and Pocahontas Counties, West Virginia where a total of 26 banking offices representing 11 banks are located. As of June 30, 2006, the most recent date data is available, Citizens held 23.0% share of the \$806 million deposit base in those counties.

Technological advances have created new ways to serve customers and new forms of competition. In 2004 we began offering internet banking as a way of reaching customers and meeting competitive demands. Internet banking thus joins our other delivery channels which include telebanking, ATMs and in-person branch delivery.

### Economic Characteristics of Citizens' Marketplace

Citizens serves an area of West Virginia including the counties of Randolph, Tucker, Grant and Pocahontas. This market is a largely rural, mountainous region covering approximately 2,876 square miles with a civilian labor force of 25,610.

The economy of this area typically does not experience highs or lows to the same degree as the national economy and is generally less prosperous than the nation as a whole. Major industries in the area include lumber and wood products, tourism, and poultry operations. Other major sources of employment include public schools, hospitals and other health care providers and various forms of local and state governmental services. As of December, 2006, the unemployment rate in this market was 5.7% compared to 4.6% for West Virginia and 4.3% nationwide. Average annual wages in the area approximate \$28,268 which is below both state and national levels. Ongoing roadway improvements are helping to improve access to and transportation within the area and are expected to provide long-term economic benefits. However, the local economy is not expected to undergo significant changes in the short-term.

### Supervision and Regulation

The following is a summary of certain statutes and regulations affecting Citizens and its subsidiary and is qualified in its entirety by reference to such statutes and regulations:

#### Bank Holding Company Regulation

Citizens is a bank holding company under the Bank Holding Company Act of 1956 ("BHCA"), which restricts its activities as well as any acquisition by it of voting stock or assets of any bank, savings association or other company. The holding company is subject to the reporting requirements of, and examination and regulation by, the Federal Reserve Board. The subsidiary bank is subject to restrictions imposed by the Federal Reserve Act on transactions with affiliates, including any loans or extensions of credit to the holding company or its subsidiaries, investments in the stock or other securities thereof and the taking of such stock or securities as collateral for loans to any borrower; the issuance of guarantees, acceptances or letters of credit on behalf of the holding company and its subsidiaries; purchases or sales of securities or other assets; and the payment of money or furnishing of services to the holding company and other subsidiaries. The bank is prohibited from acquiring direct or indirect control of more than 5% of any class of voting stock or substantially all of the assets of any bank holding company without the prior approval of the Federal Reserve Board. Citizens and its subsidiary is prohibited from engaging in certain tying arrangements in connection with extensions of credit and/or the provision of other property or services to a customer by the holding company or its subsidiaries.

The BHCA also permits Citizens to purchase or redeem its own securities. However, Regulation Y provides that prior notice must be given to the Federal Reserve Board if the gross consideration for such purchase or consideration, when aggregated with the net consideration paid by the company for all such purchases or redemptions during the preceding 12 months, is equal to 10 percent or more of the company's consolidated net worth. Prior notice is not required if (i) both before and immediately after the redemption, the bank holding company is well-capitalized; (ii) the financial holding company is well-managed and (iii) the bank holding company is not the subject of any unresolved supervisory issues.

The Gramm-Leach-Bliley Act (also known as the Financial Services Modernization Act of 1999) permits bank holding companies to become financial holding companies. This allows them to affiliate with securities firms and insurance companies and to engage in other activities that are financial in nature. A bank holding company may become a financial holding company if each of its subsidiary banks is well capitalized, is well managed and has at least a satisfactory rating under the Community Reinvestment Act. No regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board.

The Financial Services Modernization Act defines "financial in nature" to include: securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve Board has determined to be closely related to banking. A bank also may engage, subject to limitations on investment, in activities that are financial in nature, other than insurance underwriting, insurance company portfolio investment, real estate development and real estate investment, through a financial subsidiary of the bank, if the bank is well capitalized, well managed and has at least a satisfactory Community Reinvestment Act rating.

#### Bank Subsidiary Regulation

Citizens National Bank, as a national banking association, is subject to supervision, examination and regulation by the Office of the Comptroller of the Currency ("OCC"). It is also a member of the Federal Reserve System, and as such is subject to applicable provisions of the Federal Reserve Act and regulations issued thereunder.

The deposits of the bank are insured by the Federal Deposit Insurance Corporation ("FDIC") to the extent provided by law. Accordingly, the bank is also subject to regulation by the FDIC. The FDIC may terminate a bank's deposit insurance upon finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition enacted or imposed by the bank's regulatory agency.

#### Capital Requirements

As a bank holding company, Citizens is subject to the Federal Reserve Board's risk-based capital guidelines. The guidelines establish a systematic framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations, takes off-balance sheet exposures into account and minimizes disincentives to holding liquid, low-risk assets. Under the guidelines, bank holding companies must maintain capital sufficient to meet both a risk-based asset ratio test and leverage ratio test on a consolidated basis. The risk-based ratio is determined by allocating assets and specified off-balance-sheet commitments into four weighted categories, with higher levels of capital being required for categories perceived as representing greater risk.

Citizens National Bank is subject to substantially similar capital requirements adopted by its applicable regulatory agencies. In addition, the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") established a regulatory framework which ties the level of supervisory intervention by bank regulatory authorities primarily to a depository institution's capital category. Among other things, FDICIA authorized regulatory authorities to take "prompt corrective action" with respect to depository institutions that do not meet minimum capital requirements. FDICIA established five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Citizens is well capitalized as detailed in Note 14 to the accompanying consolidated financial statements.

#### Federal and State Laws

Citizens National Bank is subject to regulatory oversight under various consumer protection and fair lending laws. These laws govern, among other things, truth-in-lending disclosure, equal credit opportunity, fair credit reporting and community reinvestment. Failure to abide by federal laws and regulations governing community reinvestment could limit the ability of a bank to open a new branch or engage in a merger transaction. Community reinvestment regulations

evaluate how well and to what extent a bank lends and invests in its designated service area, with particular emphasis on low-to-moderate income communities and borrowers in such areas.

### Monetary Policy and Economic Conditions

The business of financial institutions is affected not only by general economic conditions, but also by the policies of various governmental regulatory agencies, including the Federal Reserve Board. The Federal Reserve Board regulates money and credit conditions and interest rates to influence general economic conditions primarily through open market operations in U.S. government securities, changes in the discount rate on bank borrowings and changes in the reserve requirements against depository institutions' deposits. These policies and regulations significantly affect the overall growth and distribution of loans, investments and deposits, and the interest rates charged on loans, as well as the interest rates paid on deposits.

The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of financial institutions in the past and are expected to continue to have significant effects in the future. In view of the changing conditions in the economy and the money markets and the activities of monetary and fiscal authorities, we cannot definitely predict future changes in interest rates, credit availability or deposit levels.

### Effect of Environmental Regulation

Citizens National Bank's primary exposure to environmental risk is through its lending activities. In cases when management believes environmental risk potentially exists, the bank mitigates its environmental risk exposures by requiring environmental site assessments at the time of loan origination to confirm collateral quality as to commercial real estate parcels posing higher than normal potential for environmental impact, as determined by reference to present and past uses of the subject property and adjacent sites. Environmental assessments are typically required prior to any foreclosure activity involving non-residential real estate collateral.

With regard to residential real estate lending, management reviews those loans with inherent environmental risk on an individual basis and makes decisions based on the dollar amount of the loan and the materiality of the specific credit.

We anticipate no material effect on capital expenditures, earnings or competitive position as a result of compliance with federal, state or local environmental protection laws or regulations.

### International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (USA Patriot Act)

The International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (the "Patriot Act") was adopted in response to the September 11, 2001 terrorist attacks. The Patriot Act provides law enforcement with greater powers to investigate terrorism and prevent future terrorist acts. Among the broad-reaching provisions contained in the Patriot Act are several designed to deter terrorists' ability to launder money in the United States and provide law enforcement with additional powers to investigate how terrorists and terrorist organizations are financed. The Patriot Act creates additional requirements for banks, which were already subject to similar regulations. The Patriot Act authorizes the Secretary of the Treasury to require financial institutions to take certain "special measures" when the Secretary suspects that certain transactions or accounts are related to money laundering. These special measures may be ordered when the Secretary suspects that a jurisdiction outside of the United States, a financial institution operating outside of the United States, a class of transactions involving a jurisdiction outside of the United States or certain types of accounts are of "primary money laundering concern." The special measures include the following: (a) require financial institutions to keep records and report on the transactions or accounts at issue; (b) require financial institutions to obtain and retain information related to the beneficial ownership of any account opened or maintained by foreign persons; (c) require financial institutions to identify each customer who is permitted to use a payable-through or correspondent account and obtain certain information from each customer permitted to use the account; and (d) prohibit or impose conditions on the opening or maintaining of correspondent or payable-through accounts.

### Sarbanes-Oxley

On July 30, 2002, the Senate and the House of Representatives of the United States enacted the Sarbanes-Oxley Act of 2002, a law that addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information.

Effective August 29, 2002, as directed by Section 302(a) of Sarbanes-Oxley, Citizens' chief executive officer and chief financial officer are each required to certify that Citizens' Quarterly and Annual Reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are

responsible for establishing, maintaining and regularly evaluating the effectiveness of Citizens' internal controls; they have made certain disclosures to Citizens' auditors and the audit committee of the Board of Directors about Citizens' internal controls; and they have included information in Citizens' Quarterly and Annual Reports about their evaluation and whether there have been significant changes in Citizens' internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation. Section 404 of Sarbanes-Oxley will become applicable to Citizens in 2007 based on current regulatory guidance. In response to Section 404, management will assess the company's system of internal control over financial reporting in order to determine whether the system is effective and that it meets the criteria of the Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In 2008, Section 404 will require that our independent auditors also provide an attestation on management's assertion of internal control over financial reporting.

### Item 1.A. Risk Factors

You should consider the risks described below as well as the other information included or incorporated by reference in this Annual Report on Form 10-K, before making an investment in Citizens common stock. The risks described below are not the only ones we face in our business. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also impair our business operations. If any of the following risks occur, our business, financial condition or operation results could be materially harmed. In such an event, our common stock could decline in price, and you may lose all or part of your investment.

#### **The Banking Business is Very Competitive**

As explained under Item 1 of this report, Citizens faces a high degree of competition for its services.

In particular, our competitors include national and regional financial and banking companies whose greater resources may afford them a marketplace advantage by enabling them to mount extensive promotional and advertising campaigns. Additionally, other banks and other financial institutions may have products and services not offered by Citizens, or may have greater lending capabilities due to their larger legal lending limits, which may cause current and potential customers to choose those institutions. Areas of competition include interest rates for loans and deposits, efforts to obtain deposits and range and quality of services provided. If we are unable to attract new and retain current customers, loan and deposit growth could decrease causing our results of operations and financial condition to be negatively impacted.

#### **A Deterioration in Economic Conditions Could Negatively Impact Earnings**

A downturn in local, regional or national economic conditions could negatively impact our earnings. The markets we serve in West Virginia do not have a large or diverse economic base and many customers rely on the lumber, tourism and poultry industries. A general economic slowdown, or one involving these specific industries, could have the following consequences.

- Loan delinquencies may increase;
- Problem assets and foreclosures may increase;
- Loan charge-offs and provisions for loan losses may increase;
- Demand for the products and services of the company may decline;
- Collateral (including real estate) for loans made by the company may decline in value, in turn reducing customers' borrowing power and making existing loans less secure; and
- Customers may need to withdraw existing deposits to satisfy current living expenses causing reduced liquidity.

#### **Customers May Default on the Repayment of Loans**

Our customers may default on the repayment of loans, which may negatively impact our earnings due to loss of principal and interest income. Increased operating expenses may result from the allocation of management time and resources to the collection and work-out of the loan. Collection efforts may or may not be successful causing us to write off the loan or repossess the collateral securing the loan, which may or may not exceed the balance of the loan.

Management evaluates the adequacy of the allowance for loan losses at least quarterly, which includes testing certain individual loans as well as collective pools of loans for impairment. This evaluation includes an assessment of actual loss experience within each category of the portfolio, individual commercial and commercial real estate loans that exhibit credit weakness; current economic events, including employment statistics, trends in bankruptcy filings, and other pertinent factors; industry or geographic concentrations, and regulatory guidance. Additions to the allowance for loan loss result in an expense for the period.

Our regulatory agencies periodically review the allowance for loan losses. Based on their assessment the regulatory agencies could require us to adjust the allowance for loan losses. Any such adjustments could negatively impact the results of operations or financial position.

### **Increased Commercial Lending Could Result in Increased Risk**

Much of our loan growth has centered on commercial loans including those in the lumber, tourism and lodging industries. Commercial loans are typically larger and more complex than residential and consumer lending and now represent our largest type of loan. Our ability to properly identify, measure and manage the risks involved in commercial lending, including our ability to attract and retain qualified staff, may impact the degree to which loans are realized.

### **Current Market Interest Rates and Cost of Funds may Negatively Impact Earnings**

Fluctuations in interest rates may negatively impact the business of the bank. The bank's main source of income from operations is net interest income, which is equal to the difference between the interest income received on interest-bearing assets and the interest expense incurred in connection with interest-bearing liabilities. These rates are highly sensitive to many factors beyond our control, including general economic conditions, both domestic and foreign and the monetary and fiscal policies of various governmental and regulatory authorities. The bank's net interest income can be affected significantly by changes in market interest rates. Changes in relative interest rates may reduce the bank's net interest income as the difference between interest income and interest expense decreases. As a result, the bank has adopted asset and liability management policies to minimize the potential adverse effects of changes in interest rates on net interest income, primarily by altering the mix and maturity of loans, investments and funding sources. However, even with these policies in place, we cannot assure you that a decrease in interest rates will not negatively impact its results from operations or financial position.

### **There is an Illiquid Market for the Company's Shares.**

Because a very limited market exists for the company's common stock, a shareholder may have difficulty selling his or her shares in the secondary market. We cannot predict when, if ever, we could meet the listing qualifications of the Nasdaq Stock Market's National Tier or any exchange. We cannot assure you that there will be a more active public market for the shares in the near future.

### Item 2. Properties

We provide services from offices owned by the bank including its approximately 16,940 square foot main office located at 213 Third Street, Elkins, West Virginia. In addition, the bank owns a drive-in facility directly across from its main office on Third Street and it has owned and operated a 5,000 square foot full service branch in Parsons, West Virginia since 1984. In 1992 a branch facility was opened in Beverly, West Virginia which contains approximately 1,840 square feet. This facility, which is also owned, provides drive-in and ATM service in addition to traditional deposit and teller services. Loan services, however, are not provided at the Beverly branch. During 2000 the bank acquired and opened a full service facility in Petersburg, West Virginia. That facility was expanded in 2004 to 2,980 square feet. We also constructed a full service facility in Slatyfork, West Virginia containing 3,200 square feet in 2000. All of these facilities are fully utilized for banking purposes except the Parsons branch which leases approximately 800 square feet to a cable television company.

In January 2002, the bank opened a full-service branch located in leased space within a supermarket in Marlinton, West Virginia. In 2004, we completed the construction of a 3,500 square foot free-standing branch in Marlinton and which allowed us to exit the supermarket facility.

The bank also owns two properties which adjoin its main office for future expansion. In 2006 a parking lot was constructed on one such property. The other property was leased by a tenant until April, 2006. Since the tenants vacated the property, we began using a section of the building for storage and office space. In 2004 we purchased a property adjacent to our Beverly branch as a means of both maintaining our own property value and providing for expansion needs. This facility is currently occupied by a tenant under a lease agreement which expires in 2008.

Citizens Financial Corp. does not own or lease any property. To date Citizens has utilized the bank's facilities and has not occupied more than a minimal amount of space. No compensation is paid to the bank in any way for such usage as it is deemed to be insignificant.

### Item 3. Legal Proceedings

As of December 31, 2006 Citizens Financial Corp. was not involved in any material legal proceedings. The bank

is involved in various legal proceedings which occur in the normal course of business, however. After consultation with legal counsel, we believe that all such litigation will be resolved without materially affecting the company's financial position or results of operations. In addition, there are no material proceedings known to be threatened or contemplated against the company or its subsidiaries.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders of Citizens Financial Corp. during the fourth quarter of 2006.

Part II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities

Historically, the stock of Citizens Financial Corp. has traded only sporadically. The stock is traded on the over the counter bulletin board system, and a number of brokerage firms provide an efficient and orderly market for transactions involving its shares. There are no further plans, understandings, arrangements or agreements to list the stock on any larger exchanges at this time.

Citizens has only one class of stock, that being common stock, and all voting rights are vested in its holders. The shareholders of Citizens are entitled to one vote for each share of common stock owned on all matters subject to a vote of shareholders. At February 28, 2007 shareholders of record numbered approximately 461. The company has no plans to issue any other forms of capital.

On March 7, 2006 Citizens board of directors declared a stock split which was paid on April 14, 2006 in the form of a 200% stock dividend to shareholders of record April 3, 2006. The primary reason for doing so was to reduce the share price of the stock in an effort to improve its liquidity. Citizens stock, which is neither widely held nor widely traded, is an over the counter bulletin board stock with the symbol CIWV.OB. Distribution of this stock dividend required the use of all authorized shares. On April 22, 2006 the shareholders authorized an additional 2,250,000 shares for future use.

Citizens maintains a policy under which it may purchase shares of its own stock for treasury, subject to certain limitations, when the Board of Directors determines it is in the best interest of the company to do so. Such shares are purchased on the open market through independent brokers. At December 31, 2006 and 2005 the number of treasury shares was 420,496 and 132,012, respectively. The purchase of these shares has not had a material impact on either capital or liquidity. No plans currently exist regarding their use and there are no plans regarding future purchases.

The following table presents the high and low market prices for Citizens' common stock for the periods indicated. Prices listed below that were prior to the stock split on April 14, 2006 have been restated to reflect the split.

|  | <u>High</u> | <u>Low</u> |
|--|-------------|------------|
| First Quarter through<br>February 28, 2007 | \$20.50     | \$19.50    |
| <u>2006</u>                                |             |            |
| First Quarter                              | \$19.50     | \$16.47    |
| Second Quarter                             | \$20.47     | \$16.90    |
| Third Quarter                              | \$17.67     | \$16.83    |
| Fourth Quarter                             | \$19.50     | \$17.35    |
| <u>2005</u>                                |             |            |
| First Quarter                              | \$16.50     | \$15.17    |
| Second Quarter                             | \$16.67     | \$15.75    |
| Third Quarter                              | \$17.20     | \$16.00    |
| Fourth Quarter                             | \$17.17     | \$16.33    |

The prices listed above are based upon information available to management through those brokers which deal in the company's stock as well as through certain internet quotation services and are believed to accurately represent the amount at which its stock was traded during the periods indicated. Prices reflect amounts paid by purchasers of the stock and, therefore, may include commissions or fees paid to brokers. The amounts of such commissions or fees, if any, are not known to management. No attempt was made by management to ascertain the prices for every sale made during these periods.

Citizens shareholders are entitled to receive dividends when and as declared by its Board of Directors. Dividends are typically paid quarterly. Aggregate dividends were \$0.57 per share in 2006 and \$0.53 per share in 2005. Payment of dividends by Citizens is dependent upon payment of dividends to it by the subsidiary bank. The ability of the bank to pay dividends is subject to certain limitations imposed by national banking laws as outlined in Note 14 to the accompanying consolidated financial statements.

No shares of Citizens stock have been authorized for issuance under any type of equity compensation plan. In addition, at no time during the last three years have we sold any Citizens stock which was not registered under the Securities Act of 1933.

The following table provides information with respect to Citizens' purchases of its own common stock during the fourth quarter of the fiscal year. All such purchases were made under a general policy, noted earlier, permitting the Board of Directors to make such purchases when it is believed to be in the best interest of the company to do so and not as part of any publicly announced plan or program.

#### ISSUER PURCHASES OF EQUITY SECURITIES

| Period              | Total Number of shares purchased | Average price paid per share | Total Number of shares purchased as part of publicly announced plans or programs | Maximum Number of shares that may yet be purchased under the plans or programs |
|---------------------|----------------------------------|------------------------------|--|--|
| October 1-31, 2006  | -                                | \$ -                         | N/A  | N/A  |
| November 1-30, 2006 | 6,688                            | 18.50                        | N/A  | N/A  |
| December 1-31, 2006 | -                                | -                            | N/A  | N/A  |

#### Item 6. Selected Financial Data

Selected financial data for the five years ended December 31, 2006 is presented in the following table. This summary should be read in conjunction with the consolidated financial statements and related notes included in Item 8 of this report.

Citizens Financial Corp.

#### Selected Financial Data Five Year Summary (in thousands of dollars, except per share data)

|   | 2006       | 2005       | 2004       | 2003       | 2002       |
|---|------------|------------|------------|------------|------------|
| <b>BALANCE SHEET DATA:</b>                          |            |            |            |            |            |
| Total assets  | \$ 242,980 | \$ 238,190 | \$ 213,783 | \$ 209,129 | \$ 182,400 |
| Securities  | 59,746     | 66,854     | 53,874     | 60,077     | 54,219     |
| Loans, net  | 166,218    | 152,136    | 144,587    | 134,311    | 115,187    |
| Deposits  | 196,543    | 190,486    | 165,301    | 161,549    | 147,741    |
| Total shareholders' equity                          | 20,278     | 19,613     | 20,223     | 20,478     | 20,605     |
| <b>SUMMARY OF OPERATIONS:</b>                       |            |            |            |            |            |
| Interest income                                     | \$ 15,351  | \$ 12,976  | \$ 11,443  | \$ 11,415  | \$ 11,519  |
| Interest expense                                    | 5,856      | 4,056      | 3,073      | 3,193      | 3,972      |
| Net interest income                                 | 9,495      | 8,920      | 8,370      | 8,222      | 7,547      |
| Provision for loan losses                           | 423        | 275        | 935        | 324        | 288        |
| Net interest income after provision for loan losses | 9,072      | 8,645      | 7,435      | 7,898      | 7,259      |
| Noninterest income                                  | 1,630      | 1,468      | 1,393      | 1,292      | 1,353      |
| Noninterest expense                                 | 7,659      | 7,139      | 6,745      | 6,194      | 5,692      |
| Income before income taxes                          | 3,043      | 2,974      | 2,083      | 2,996      | 2,920      |
| Income taxes  | 956        | 927        | 427        | 984        | 992        |

|            |                 |                 |                 |                 |                 |
|------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Net income | <u>\$ 2,087</u> | <u>\$ 2,047</u> | <u>\$ 1,656</u> | <u>\$ 2,012</u> | <u>\$ 1,928</u> |
|------------|-----------------|-----------------|-----------------|-----------------|-----------------|

**PER SHARE DATA\*:**

|                |                |                |                |                |                |
|----------------|----------------|----------------|----------------|----------------|----------------|
| Net income     | <u>\$ 1.13</u> | <u>\$ 1.10</u> | <u>\$ 0.88</u> | <u>\$ 1.05</u> | <u>\$ 0.99</u> |
| Cash dividends | <u>\$ 0.57</u> | <u>\$ 0.53</u> | <u>\$ 0.52</u> | <u>\$ 0.50</u> | <u>\$ 0.47</u> |

\*Restated to reflect stock split in the form of a 200% stock dividend declared in March 2006.

Additional information required under Securities Act Industry Guide 3 for Bank Holding Companies follows:

Distribution of Assets, Liabilities & Shareholders' Equity;  
Interest Rates and Interest Differential

|   | 2006                      |                 |              | 2005                      |                 |              | 2004                      |                 |              |
|---|---------------------------|-----------------|--------------|---------------------------|-----------------|--------------|---------------------------|-----------------|--------------|
|   | Avg Bal                   | Interest        | Yield/Rate   | Avg Bal                   | Interest        | Yield/Rate   | Avg Bal                   | Interest        | Yield/Rate   |
|   | (in thousands of dollars) |                 |              | (in thousands of dollars) |                 |              | (in thousands of dollars) |                 |              |
| Interest Earning Assets:  |                           |                 |              |                           |                 |              |                           |                 |              |
| Federal funds sold and interest bearing deposits with other banks | \$ 1,377                  | \$ 68           | 4.94%        | \$ 3,807                  | \$ 123          | 3.23%        | \$ 1,506                  | \$ 18           | 1.19%        |
| Securities:   |                           |                 |              |                           |                 |              |                           |                 |              |
| Taxable   | 53,267                    | 2,046           | 3.84         | 51,340                    | 1,781           | 3.47         | 45,362                    | 1,634           | 3.60         |
| Tax-exempt (1)  | 8,555                     | 459             | 5.37         | 8,825                     | 496             | 5.62         | 8,721                     | 479             | 5.49         |
| Loans (net of unearned interest) (1) (2)                          | 162,252                   | 13,004          | 8.01         | 149,177                   | 10,799          | 7.24         | 142,296                   | 9,542           | 6.71         |
| Total interest earning assets (1)                                 | <u>225,451</u>            | <u>15,577</u>   | <u>6.91</u>  | <u>213,149</u>            | <u>13,199</u>   | <u>6.19</u>  | <u>197,885</u>            | <u>11,673</u>   | <u>5.90</u>  |
| Nonearning assets:  |                           |                 |              |                           |                 |              |                           |                 |              |
| Cash and due from banks   | 6,258                     |                 |              | 5,981                     |                 |              | 5,417                     |                 |              |
| Bank premises and equipment, net                                  | 4,194                     |                 |              | 4,205                     |                 |              | 4,075                     |                 |              |
| Other assets  | 5,311                     |                 |              | 4,642                     |                 |              | 5,572                     |                 |              |
| Allowance for loan losses   | (1,750)                   |                 |              | (1,512)                   |                 |              | (1,293)                   |                 |              |
| Total assets  | <u>\$239,464</u>          |                 |              | <u>\$226,465</u>          |                 |              | <u>\$211,656</u>          |                 |              |
| Interest Bearing Liabilities:                                     |                           |                 |              |                           |                 |              |                           |                 |              |
| Savings deposits  | \$ 23,608                 | 121             | 0.51         | \$ 26,077                 | 130             | 0.50         | \$ 27,604                 | 127             | 0.46         |
| Time deposits   | 89,731                    | 3,566           | 3.97         | 82,768                    | 2,583           | 3.12         | 76,565                    | 2,134           | 2.79         |
| NOW accounts  | 44,495                    | 1,161           | 2.61         | 37,057                    | 613             | 1.65         | 31,306                    | 347             | 1.11         |
| Money market accounts   | 6,538                     | 33              | 0.50         | 7,165                     | 50              | 0.69         | 7,478                     | 38              | 0.50         |
| Borrowings  | 26,215                    | 975             | 3.72         | 26,933                    | 680             | 2.52         | 23,719                    | 427             | 1.80         |
| Total interest bearing liabilities                                | <u>190,587</u>            | <u>5,856</u>    | <u>3.07</u>  | <u>180,000</u>            | <u>4,056</u>    | <u>2.25</u>  | <u>166,672</u>            | <u>3,073</u>    | <u>1.84</u>  |
| Noninterest bearing liabilities:                                  |                           |                 |              |                           |                 |              |                           |                 |              |
| Demand deposits   | 26,019                    |                 |              | 24,696                    |                 |              | 22,889                    |                 |              |
| Other liabilities   | 2,574                     |                 |              | 1,348                     |                 |              | 1,535                     |                 |              |
| Shareholders' equity  | <u>20,284</u>             |                 |              | <u>20,421</u>             |                 |              | <u>20,560</u>             |                 |              |
| Total liabilities and shareholder's equity                        | <u>\$239,464</u>          |                 |              | <u>\$226,465</u>          |                 |              | <u>\$211,656</u>          |                 |              |
| Net interest income (1)   |                           | <u>\$ 9,721</u> |              |                           | <u>\$ 9,143</u> |              |                           | <u>\$ 8,600</u> |              |
| Net interest income to average earning assets (1)                 |                           |                 | <u>4.31%</u> |                           |                 | <u>4.29%</u> |                           |                 | <u>4.35%</u> |

(1) Yields on tax-exempt holdings are expressed on a tax equivalent basis using a 34% tax rate.

(2) For the purpose of these computations, nonaccruing loans are included in the amounts of average loans outstanding.

### Rate Volume Analysis

The following table sets forth a summary on the changes in interest earned and interest expense detailing the amounts attributable to (i) changes in volume (change in the average volume times the prior year's average rate), (ii) changes in rate (change in the average rate times the prior year's average volume). The changes in rate/volume (change in the average volume times the change in the average rate), has been allocated to the changes in volume and changes in rate in proportion to the relationship of the absolute dollar amounts of the change in each.

|   | 2006 Compared to 2005     |                |               | 2005 Compared to 2004 |               |               |
|---|---------------------------|----------------|---------------|-----------------------|---------------|---------------|
|   | Increase                  | (Decrease)     | Due to        | Increase              | (Decrease)    | Due to        |
|   | Volume                    | Rate           | Total         | Volume                | Rate          | Total         |
|   | (in thousands of dollars) |                |               |                       |               |               |
| Interest earned on:   |                           |                |               |                       |               |               |
| Federal funds sold and interest bearing deposits with other banks | \$ (102)                  | \$ 48          | \$ (54)       | \$ 50                 | \$ 55         | \$ 105        |
| Taxable securities  | 69                        | 196            | 265           | 209                   | (65)          | 144           |
| Tax-exempt securities   | (15)                      | (22)           | (37)          | (43)                  | (8)           | (51)          |
| Loans   | 996                       | 1,208          | 2,204         | 538                   | 790           | 1,328         |
| Total interest earned   | <u>948</u>                | <u>1,430</u>   | <u>2,378</u>  | <u>754</u>            | <u>772</u>    | <u>1,526</u>  |
| Interest expense on:  |                           |                |               |                       |               |               |
| Savings deposits  | (12)                      | 3              | (9)           | (7)                   | 10            | 3             |
| Time deposits   | 232                       | 750            | 982           | 183                   | 267           | 450           |
| NOW accounts  | 141                       | 407            | 548           | 73                    | 193           | 266           |
| Money market accounts   | (4)                       | (12)           | (16)          | (2)                   | 14            | 12            |
| Other borrowing   | (19)                      | 314            | 295           | 64                    | 188           | 252           |
| Total interest expense  | <u>338</u>                | <u>1,462</u>   | <u>1,800</u>  | <u>311</u>            | <u>672</u>    | <u>983</u>    |
| Net interest income   | <u>\$ 610</u>             | <u>\$ (32)</u> | <u>\$ 578</u> | <u>\$ 443</u>         | <u>\$ 100</u> | <u>\$ 543</u> |

### Securities Portfolio

Presentation of the amortized cost of securities as of December 31, 2006 and 2005 may be found in Note 4 to the accompanying consolidated financial statements.

The following table sets forth the maturities of securities as of December 31, 2006 and the weighted average yields of such securities (calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security).

|   | Within One Year        |              | After One but Within Five Years |              | After Five but Within Ten Years |              | After Ten Years      |             | Total                  |              |
|---|------------------------|--------------|---------------------------------|--------------|---------------------------------|--------------|----------------------|-------------|------------------------|--------------|
|   | Amount                 | Yield        | Amount                          | Yield        | Amount                          | Yield        | Amount               | Yield       | Amount                 | Yield        |
| (in thousands of dollars)   |                        |              |                                 |              |                                 |              |                      |             |                        |              |
| U.S. Treasury and other U.S. government agencies and corporations | \$ 18,141              | 3.32%        | \$32,154                        | 4.41%        | \$ -                            | - %          | \$ -                 | - %         | \$50,295               | 4.02%        |
| State and political subdivisions (1)                              | 1,537                  | 4.82         | 6,701                           | 5.17         | 945                             | 5.27         | -                    | -           | 9,183                  | 5.12         |
| Other securities  | <u>-</u>               | <u>-</u>     | <u>-</u>                        | <u>-</u>     | <u>-</u>                        | <u>-</u>     | <u>878</u>           | <u>3.37</u> | <u>878</u>             | <u>3.37</u>  |
| <b>Total</b>  | <b><u>\$19,678</u></b> | <b>3.44%</b> | <b><u>\$38,855</u></b>          | <b>4.54%</b> | <b><u>\$ 945</u></b>            | <b>5.27%</b> | <b><u>\$ 878</u></b> | <b>3.37</b> | <b><u>\$60,356</u></b> | <b>4.18%</b> |

The portfolio contains no securities of any single issuer in which the aggregate amortized cost of such securities exceeds ten percent of shareholders' equity.

(1) Tax-equivalent adjustments, using a rate of 34%, have been made in calculating yields on obligations of state and political subdivisions.

## Loan Portfolio

### Types of Loans

The distribution of loans by major category for each of the last five fiscal year ends are provided below. All loans in the portfolio are domestic in nature.

|  | December 31               |                  |                  |                  |                  |
|--|---------------------------|------------------|------------------|------------------|------------------|
|  | 2006                      | 2005             | 2004             | 2003             | 2002             |
|  | (in thousands of dollars) |                  |                  |                  |                  |
| Commercial, financial and agricultural | \$ 26,969                 | \$ 26,589        | \$ 23,831        | \$ 25,417        | \$ 20,819        |
| Real estate-construction               | 13,964                    | 10,559           | 8,759            | 5,963            | 2,689            |
| Real estate-mortgage                   | 114,966                   | 104,868          | 101,083          | 89,111           | 77,937           |
| Installment loans                      | 10,635                    | 9,726            | 10,734           | 12,396           | 13,657           |
| Other                                  | 1,611                     | 2,051            | 1,636            | 2,868            | 1,566            |
| Total loans                            | <u>\$168,145</u>          | <u>\$153,793</u> | <u>\$146,043</u> | <u>\$135,755</u> | <u>\$116,668</u> |

### Loan Maturities and Interest Rate Sensitivity

Note 5 to the accompanying consolidated financial statements also provides data concerning the contractual maturities of loans, including commercial, financial and agricultural loans as well as real estate construction loans, as of December 31, 2006. Also provided are the amounts due after one year classified as fixed rate and variable rate loans.

### Risk Elements

#### Nonperforming Loans

The table below presents our nonperforming loan data for each of the last five fiscal year ends:

|  | December 31               |              |              |              |              |
|--|---------------------------|--------------|--------------|--------------|--------------|
|  | 2006                      | 2005         | 2004         | 2003         | 2002         |
|  | (in thousands of dollars) |              |              |              |              |
| Nonaccrual loans                                       | \$2,208                   | \$ 58        | -            | \$ 16        | \$ 14        |
| Loans past due 90 days or more still accruing interest | -                         | 538          | 559          | 352          | 57           |
| Troubled debt restructurings                           | -                         | -            | -            | -            | -            |
| Total  | <u>\$2,208</u>            | <u>\$596</u> | <u>\$559</u> | <u>\$368</u> | <u>\$ 71</u> |

#### Potential Problem Loans

As stated in Note 6 to the accompanying consolidated financial statements, impaired loans totaled \$5,147,663 and \$3,650,075 at December 31, 2006 and 2005. These loans were classified as impaired due to doubts about the borrower's ability to repay as called for in the loan documents. Additional information regarding these loans may also be found in Note 6.

#### Loan Concentrations

Information concerning loan concentrations is provided in Note 5 to the accompanying consolidated financial statements.

#### Summary of Loan Loss Experience

The following table provides an analysis of our allowance for loan losses for each of the last five fiscal year ends.

|  | December 31               |         |         |         |         |
|--|---------------------------|---------|---------|---------|---------|
|  | 2006                      | 2005    | 2004    | 2003    | 2002    |
|  | (in thousands of dollars) |         |         |         |         |
| Balance, beginning of year             | \$1,597                   | \$1,378 | \$1,396 | \$1,386 | \$1,398 |
| Charge offs:                           |                           |         |         |         |         |
| Commercial, financial and agricultural | 123                       | -       | 1,031   | 129     | 134     |
| Real estate-mortgage                   | -                         | -       | 36      | 24      | 56      |
| Installment                            | 39                        | 90      | 98      | 190     | 138     |

|  |                |                |                |                |                |
|--|----------------|----------------|----------------|----------------|----------------|
| Total                                  | <u>162</u>     | <u>90</u>      | <u>1,165</u>   | <u>343</u>     | <u>328</u>     |
| Recoveries:                            |                |                |                |                |                |
| Commercial, financial and agricultural | 4              | 5              | 192            | 21             | 3              |
| Real estate-mortgage                   | -              | 1              | -              | -              | 1              |
| Installment                            | <u>11</u>      | <u>28</u>      | <u>20</u>      | <u>8</u>       | <u>24</u>      |
| Total                                  | <u>15</u>      | <u>34</u>      | <u>212</u>     | <u>29</u>      | <u>28</u>      |
| Net charge offs                        | 147            | 56             | 953            | 314            | 300            |
| Provisions for loan losses             | <u>423</u>     | <u>275</u>     | <u>935</u>     | <u>324</u>     | <u>288</u>     |
| Balance, end of year                   | <u>\$1,873</u> | <u>\$1,597</u> | <u>\$1,378</u> | <u>\$1,396</u> | <u>\$1,386</u> |

The amount charged to the provision for loan losses and the related balance in the allowance for loan losses is based upon periodic evaluations of the loan portfolio by management. These evaluations consider several factors including, but not limited to, its analysis of overall loan quality, changes in the mix and size of the loan portfolio, previous loss experience, general economic conditions and information about specific borrowers.

The ratio of net losses to average loans outstanding was 0.09% in 2006, 0.04% in 2005 and 0.67% in 2004.

The following tables provide an allocation of the allowance for loan losses for each of the last five year ends as well as the percent of loans in each category to total loans.

|  | Allocation of Allowance For Loan Losses |                 |                 |                 |                 |
|--|---|-----------------|-----------------|-----------------|-----------------|
|  | December 31,                            |                 |                 |                 |                 |
|  | 2006                                    | 2005            | 2004            | 2003            | 2002            |
| Commercial, financial and agricultural | \$ 1,077                                | \$ 901          | \$ 717          | \$ 810          | \$ 918          |
| Real estate-construction               | -                                       | -               | -               | -               | 17              |
| Real estate-mortgage                   | 589                                     | 320             | 282             | 103             | 164             |
| Installment and other                  | 65                                      | 151             | 173             | 185             | 103             |
| Unallocated                            | <u>142</u>                              | <u>225</u>      | <u>206</u>      | <u>298</u>      | <u>184</u>      |
| Total                                  | <u>\$ 1,873</u>                         | <u>\$ 1,597</u> | <u>\$ 1,378</u> | <u>\$ 1,396</u> | <u>\$ 1,386</u> |

|  | Percent of Loans in Each Category to Total Loans |             |             |             |             |
|--|--|-------------|-------------|-------------|-------------|
|  | December 31,                                     |             |             |             |             |
|  | 2006   | 2005        | 2004        | 2003        | 2002        |
| Commercial, financial and agricultural | 16%  | 17%         | 16%         | 19%         | 18%         |
| Real estate-construction               | 8  | 7           | 6           | 4           | 2           |
| Real estate-mortgage                   | 68   | 68          | 69          | 66          | 67          |
| Installment and other                  | <u>8</u>   | <u>8</u>    | <u>9</u>    | <u>11</u>   | <u>13</u>   |
| Total                                  | <u>100%</u>                                      | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

### Deposits

The average daily amount of deposits and the rates paid on those deposits for the years ended December 31, 2006, 2005 and 2004 were previously presented in the Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential.

A table summarizing the maturities of time certificates of deposit, including individual retirement accounts, of \$100,000 or more as of December 31, 2006 may be found in Note 8 to the accompanying consolidated financial statements. There were no other time deposits of \$100,000 or more at that date.

### Return on Equity and Assets

The following table shows consolidated operating and capital ratios for the periods indicated.

|                          | Year Ended December 31 |      |      |
|--------------------------|------------------------|------|------|
|                          | 2006                   | 2005 | 2004 |
| Return on average assets | 0.87%                  | .90% | .78% |

|                                |       |       |       |
|--------------------------------|-------|-------|-------|
| Return on average equity       | 10.29 | 10.02 | 8.06  |
| Dividend payout ratio          | 50.24 | 48.49 | 58.94 |
| Average equity to assets ratio | 8.47  | 9.02  | 9.71  |

### Short-term Borrowing

Information concerning the company's short-term borrowings is presented in Note 12 to the accompanying consolidated financial statements.

### Disclosure of Contractual Obligations

The following table provides information regarding the contractual obligations of Citizens Financial Corp. at December 31, 2006:

| Total | Payments Due By Period<br>(in thousands of dollars) |                |               |                      |
|-------|---|----------------|---------------|----------------------|
|       | Less than<br>1 year                                 | 1 – 3<br>years | 3 -5<br>years | More than<br>5 years |

### Contractual obligations

|                                |                |               |               |               |                |
|--------------------------------|----------------|---------------|---------------|---------------|----------------|
| Long-term debt                 | \$3,512        | \$ 793        | \$ 769        | \$ 841        | \$1,109        |
| Capital leases                 | -              | -             | -             | -             | -              |
| Operating leases               | 139            | 43            | 66            | 30            | -              |
| Purchase obligations           | -              | -             | -             | -             | -              |
| Other long-term<br>Liabilities | -              | -             | -             | -             | -              |
| Total                          | <u>\$3,651</u> | <u>\$ 836</u> | <u>\$ 835</u> | <u>\$ 871</u> | <u>\$1,109</u> |

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

### INTRODUCTION

The following discussion and analysis presents the significant changes in financial condition and results of operations of Citizens Financial Corp. and our subsidiary, Citizens National Bank of Elkins, for the periods indicated. It should be read in conjunction with the consolidated financial statements and accompanying notes thereto, which are included elsewhere in this report.

### Description of Business

Citizens Financial Corp. is a \$243 million Delaware corporation headquartered in Elkins, West Virginia. From there our wholly-owned subsidiary, Citizens National Bank of Elkins, provides loan, deposit, trust, brokerage and other banking and banking related services to customers in northcentral and eastern West Virginia and nearby areas through six branch offices. We conduct no business other than the ownership of our bank subsidiary.

### FORWARD LOOKING STATEMENTS

This report contains forward looking statements which reflect our current expectations based on information available to us. These forward looking statements involve uncertainties related to the general economic conditions in our nation and other broad based issues such as interest rates and regulations as well as to other factors which may be more specific to our own operations. Examples of such factors may include our ability to attract and retain key personnel, implementing new technological systems, providing new products to meet changing customer and competitive demands, our ability to successfully manage growth strategies, controlling costs, maintaining our net interest margin, maintaining good credit quality, and others. Forward looking statements can be identified by words such as "may", "will", "expect", "anticipate", "believe", "estimate", "plans", "intends", or similar words. We do not attempt to update any forward looking statements. When provided, we intend forward looking information to assist readers in understanding anticipated future operations and we include them pursuant to applicable safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Although we believe the expectations reflected in our forward looking statements are reasonable, actual results could differ materially.

### CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles and follow general practices within the financial services industry. Application of these principles requires us to make estimates, assumptions, and judgments that affect the amounts reported in our financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements and could change as new information becomes available. Consequently, later financial statements could reflect different estimates, assumptions, and judgments.

Some policies rely more heavily on the use of estimates, assumptions, and judgments than others and, therefore, have a greater possibility of producing results that could be materially different than originally reported. Our most significant accounting policies, including an explanation of how assets and liabilities are valued, may be found in Note 1 to the consolidated financial statements in our 2006 Annual Report to Shareholders and Form 10-K.

The allowance for loan losses represents our estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, the estimated amount of losses in pools of homogeneous loans, and the effect of various economic and business factors, all of which may be subject to significant change. Due to these uncertainties, as well as the sensitivity of our financial statements to the assumptions and estimates needed to determine the allowance, we have identified the determination of the allowance for loan losses as a critical accounting estimate. As such, it could be subject to revision as new information becomes available. Should this occur, changes to the provision for loan losses, which may increase or decrease future earnings, may be necessary. A discussion of the methods we use to determine our allowance for loan losses is presented later in this report.

## OVERVIEW

The bank experienced a year of controlled growth in 2006 with assets rising by approximately \$4,791,000 to \$242,980,000. This reflects better than expected deposit levels where we had expected certain balances to decrease but instead retained key relationships leading to an overall increase in total deposits of \$6,058,000. This, together with the liquidation of \$7,109,000 of securities, allowed us to satisfy demand for residential mortgage and commercial real estate loan projects. In total, our gross loan portfolio grew by \$14,352,000, or 9.3%, to \$168,145,000 which is consistent with our expectations.

Income for the year was \$2,087,000, up \$40,000 or 1.9% from 2005. This was significantly less than anticipated due to a number of nonrecurring items which will be detailed later in this report. As a result, our return on average assets of .87% was similar to last year's .90%. Absent the nonrecurring expenses, income would have approximated \$2,404,000 resulting in a return on average assets of 1.00%.

Per share earnings increased by \$.03 to \$1.13 while our strong capital position allowed us to increase the dividend from \$.53 to \$.57 per share, our fifteenth straight year of dividend increases. Each of these per share measures reflects a restatement of our 2005 data in order to recognize the effect of a stock split in the form of a 200% stock dividend which was declared by the board of directors in March and subsequently distributed to shareholders in April, 2006. A more detailed discussion of the factors impacting our results of operations and financial condition follows. Amounts and percentages used in that discussion, as well as in this overview, have been rounded.

## Results of Operations

### Net Interest Income

Net interest income represents the primary component of our earnings. It is the difference between interest and fee income generated by interest earning assets and interest expense incurred to carry interest bearing liabilities. Net interest income is affected by changes in balance sheet composition and interest rates. We attempt to maximize net interest income by determining the optimal product mix in light of current and expected yields on assets, cost of funds and economic conditions while maintaining an acceptable degree of risk.

Net interest income improved in 2006 rising \$575,000 to \$9,495,000. On a tax equivalent basis the net interest income increased to \$9,721,000 while our net interest margin of 4.31% is up slightly from 4.29% last year.

On a tax equivalent basis interest income rose \$2,378,000 to \$15,577,000. This reflects both higher yields and an increase in our earning asset base, especially with respect to loans. The effective yield on our loans increased 77 basis points to 8.01% while our average loan volume was up \$13.1 million to \$162.3 million. These two factors directly produced a tax equivalent increase in interest income of \$2,204,000. Overall, our yield on earning assets increased 72 basis points to 6.91% while our earning asset base of \$225,451,000 was up \$12.3 million.

Interest expense, the other component of net interest income, was also up in 2006 rising \$1,800,000 to \$5,856,000. Higher rates on CDs, interest bearing checking accounts and borrowed funds caused interest expense to increase \$1,462,000. Higher volumes of interest bearing liabilities were a less significant factor as they caused a \$338,000 increase in expense. Taken as a whole our interest bearing liabilities rose \$10,587,000 to \$190,587,000. The cost of these liabilities also went up, rising 82 basis points to 3.07%.

By contrast, in 2005 tax-equivalent net interest income increased just \$543,000 with interest income rising \$1,526,000 but interest expense also rising \$983,000. The improvement in interest income was nearly equally the result of a \$15.3 million increase in the earning asset base and a 29 basis point improvement in yield. The higher interest expense was primarily due to a 41 basis point increase in cost.

### Provision for Loan Losses

The provision for loan losses is our estimate of the amount which must be charged against current earnings in order to maintain the allowance for loan losses at a level considered adequate to provide for losses which are inherent in the loan portfolio. This amount is determined through quarterly evaluations of the loan portfolio. Our provision for loan losses totaled \$423,000 in 2006 compared to \$275,000 in 2005 and \$935,000 in 2004. The increase in 2006, reflects higher levels of credit risk as indicated by several risk measurements and as explained later in this report. The high level of charge-offs in 2004 is the result of higher net charge-offs primarily arising from the failure of a commercial loan customer.

Because the amount of the provision for loan losses is a function of our overall assessment of loan quality and the adequacy of the allowance for loan losses, which itself relies on significant use of judgment and estimates, the provision for loan loss expense may increase or decrease in the future. Please refer to the Credit Quality and Allowance for Loan Losses section of this report where we further discuss the estimation methods and assumptions we use in analyzing the allowance and the quality of our loan portfolio as these are critical factors in the determination of our provision for loan losses.

### Noninterest Income

Noninterest income, which includes all revenues other than interest and fees on earning assets, is an important factor in our overall profitability. Total noninterest income in 2006 of \$1,630,000 compares to \$1,468,000 in 2005 and \$1,393,000 in 2004. Annual increases were \$162,000 in 2006 and \$75,000 in 2005.

This positive trend is the result of several factors, most notably rising levels of service fees and brokerage fees. Service fees are the largest single component of noninterest income and increased \$80,000 in 2006 due to higher overdraft fees and rising ATM fees from an expansion of our ATM network. In 2005 service fees rose by \$71,000 resulting mainly from the same two factors. Brokerage fees increased by \$38,000 in 2006 and \$29,000 in 2005. Prior to 2005 we had difficulty keeping a licensed professional broker on staff. However, since September 2004 we have benefited from the consistent service of the same broker and have established a successful brokerage effort.

Other noninterest income was also a major factor in 2006's improvement increasing by \$55,000 to \$326,000 largely due to a \$32,000 gain on the sale of real estate. Trust income, insurance commissions and secondary market loan fees did not change significantly in 2006.

We did recognize losses on the sale of securities approximating \$18,000 in 2006. These losses were recovered prior to year-end by reinvesting in higher yielding securities. No security gains or losses were recognized in 2005 while gains of \$23,000 were recorded in 2004.

We plan to perform a review of our noninterest income in 2007 to identify areas which might produce increased revenue. It is our belief that we may be able to improve performance in several areas and that our diverse services, such as trust, brokerage and secondary market mortgages, provide us with a competitive advantage in several of our markets.

### Noninterest Expense

Noninterest expense includes all items of expense other than interest expense, the provision for loan losses, and income taxes. Historically, our level of noninterest expense has been higher than average, partly due to the relatively smaller branch facilities our market area can support. It has also been increasing annually and is clearly a detriment to earnings.

Despite efforts to control noninterest expense in 2006, a number of nonrecurring and strategic expenses presented themselves during the year causing yet another large increase of \$520,000 bringing total annual noninterest

expense to \$7,659,000. Absent these items noninterest expense would have approximated \$7,208,000, an increase of just \$69,000 from 2005. Foremost among these nonrecurring items are legal and professional fees of \$125,000, expenses related to foreclosed properties of \$204,000, data processing conversion charges of \$43,000, and \$40,000 incurred to recruit new members of our management team. Despite the data processing costs cited above, total data processing costs for the year decreased by \$75,000 as we have switched to a new third party core processor.

Personnel costs, which are the largest component of noninterest expense, increased by \$203,000, or 5.4%, to \$3,926,000 in 2006. Included in this is salary expense of \$2,756,000, up \$90,000 due to the hiring of a new chief credit officer, credit analyst, and branch coordinator. We believe these three individuals are key to our future success and ongoing workflow realignment will help offset the increased cost. Pension costs, as determined under applicable accounting standards, increased by \$70,000 in 2006 to \$133,000.

Other noninterest expense, which totaled \$1,246,000 for the year, actually increased more than any other item within noninterest expense rising \$279,000 or 28.9%. Of this increase, \$195,000 was related to the upkeep and disposition of foreclosed properties. Also found here are \$40,000 of recruitment costs noted earlier and \$25,000 paid to settle legal claims

Professional service fees saw a dramatic increase of \$104,000, or 42.2%, to \$350,000 in 2006 due to the outsourcing of our loan review function and the retention of other professionals to assist with our data processing conversion and to implement organizational and workflow changes. This follows 2005 when professional services increased \$86,000 partly due to the outsourcing of our internal audit function. Professional fees are expected to be high again in 2007 as we continue to outsource internal audit and loan review and become subject to additional requirements under the Sarbanes-Oxley Act. Among the other components of noninterest expense, data processing dropped by \$75,000 as previously noted, and equipment expense fell \$45,000 due to lower depreciation. Net occupancy expense increased \$51,000 reflecting a loss of rental income. We do not foresee regaining this income in 2007. The remaining items such as director fees, postage, stationery and software expense all changed by lesser amounts.

Noninterest expenses also increased in 2005, rising \$394,000 to \$7,139,000. In addition to the increase in professional fees noted previously, benefit costs, occupancy expenses such as utilities, repairs and property insurance, and the cost to purchase and maintain software programs all contributed to the increase.

### Income Taxes

Our provision for income taxes includes both federal and state income taxes. Total taxes were \$956,000 in 2006, \$927,000 in 2005, and \$427,000 in 2004. The drop in our 2004 tax is primarily related to the unusually high level of loan charge-offs we experienced. With the exception of income earned on loans to and bonds issued by municipalities, and income from certain life insurance policies, all of our income is taxable. We have not been subject to the alternative minimum tax during any of the periods covered by this report. Note 10 of the accompanying consolidated financial statements provides additional information concerning our income tax expense.

### Financial Condition

#### Loan Portfolio

We attempt to satisfy loan demand within our market by offering a variety of consumer, home mortgage, and commercial loans. The majority of our loans are made to borrowers within our market area although the economic limits of those markets cause us to seek out-of-area loans on occasion. These loans are made through a group of community banks similar to ourselves. These out-of-area loans comprise just 4.6% of our \$168,145,000 loan portfolio and our primary focus will remain on lending opportunities within our markets.

Our loan portfolio experienced growth of \$14,352,000 in 2006. As has been the case in recent years, we continued to experience growth in our commercial real estate portfolio which increased \$4.6 million to \$45,579,000 in 2006. These loans are made to various commercial customers, including those operating at or near local ski resorts, and usually carry variable rates tied to prime. When combined with our commercial loan portfolio of \$26,969,000, our total loans for commercial purposes are \$72,548,000 making commercial lending our largest group of loans.

Residential mortgage lending, which was our largest portfolio until recent years, remains a very important part of our lending activity. In 2006 we actively sought to increase the size of this portfolio as a way to diversify our loans and to develop more complete relationships with consumers. To do this we offered several fixed rate mortgage products in addition to our typical adjustable rate mortgages. This effort was successful in increasing the residential mortgage portfolio by \$6,274,000 to \$61,401,000. This was the largest increase among any of our loan portfolios in 2006.

We similarly sought to increase our consumer loan portfolio. After several years of decreasing balances due to attractive financing terms offered by auto manufacturers, we successfully increased the portfolio by \$909,000 by focusing on used auto loans and improving relationships with local dealers. When possible, we will continue our efforts to increase our consumer and residential mortgage portfolios in 2007.

Among our other portfolios, construction lending increased as expected while home equity lending experienced a slight drop.

#### Credit Quality and Allowance for Loan Losses

The nature of the lending process exposes all banks to some level of credit risk. Managing that risk to promote a safe and sound institution is a key banking objective.

During 2006 several of our credit risk measures increased. Past due loans at year-end of \$5,347,000 were up \$105,000 from the end of 2005 while loans more than 90 days past due increased by \$490,000 to \$1,086,000. Similarly, nonaccrual loans increased by \$2,150,000 to \$2,208,000 while impaired loans of \$5,148,000 were up from \$3,650,000. While these data do point to an increase in credit risk, a portion of the increases may be attributed to improved monitoring and recognition procedures as noted later in this discussion. In most cases we are well secured which helps limit our risk of loss and in 2006 actual net charge offs of \$147,000 were within historical norms. We believe we are well equipped to manage and resolve the risks in our portfolio and have assigned the management of our most crucial credits to one of our senior lenders. We expect a positive resolution to a number of these situations in the near future.

By assigning our most crucial credits to one of our senior lenders we have developed strategies to manage them. We have also taken a number of other steps to improve our credit risk management capabilities. Among them are adopting a new loan policy and credit grading system, installing improved systems to track loan exceptions and requiring loan officers to be more involved in collection efforts. In addition to this we retained an experienced chief credit officer and credit analyst capable of dealing with the more complex commercial credits we are becoming involved in. We are convinced these improvements have already made us a better bank.

All of these steps help us manage the risk in our loan portfolio. The inherent risk of loss which the portfolio contains is addressed through the allowance for loan losses. We maintain our allowance for loan losses at a level we consider adequate to provide for losses that we believe are inherent in the loan portfolio. This determination is based on quarterly evaluations in which a specific analysis and a pooled analysis are computed. The specific analysis is used to individually assign an allowance to larger balance, nonhomogenous loans; typically commercial loans. The pooled analysis is used to quantify the loss on pools of smaller balance, homogenous loans such as residential mortgages and consumer loans. The pooled analysis considers such factors as historical loss experience, delinquency levels, current and anticipated economic conditions, concentrations of credit and changes in lending policies and staff. Because these analyses determine the adequacy of the allowance for loan losses they also determine the provision for loans losses that must be charged to earnings.

As of December 31, 2006, our allowance for loan losses was \$1,873,000, or 1.12% of gross loans compared to \$1,597,000 at year-end 2005 or 1.04% of gross loans. Within our analysis we specifically analyzed more than \$17.5 million of loans finding that \$4,892,000 required the establishment of specific reserves. The amount of those reserves was \$990,000. Estimated losses on our smaller pools of loans totaled \$354,000. Further adjustments to the allowance of \$529,000 were made after analyzing the economic factors cited in the previous paragraph.

Based on information available to us we believe our analysis is comprehensive and our allowance is adequate as of the report date. However, there can be no assurance that additional provisions for loan losses will not be required in the future as a result of changes in the assumptions which underlie our estimates and judgments or changes in economic conditions or the conditions of individual borrowers.

#### Securities Portfolio and Federal Funds Sold

Funds which are not needed to satisfy loan demand or operating needs are invested in securities as a means of improving earnings while also providing liquidity and balancing interest sensitivity concerns. The securities we purchase are limited to U.S. government agency issues, including mortgage backed issues of U.S. agencies, obligations of state and political subdivisions and investment grade corporate debt. However, at year-end we held no corporate securities. All of our securities are classified as available for sale. The Board of Directors is informed of all securities transactions each month and a series of policy statements limit the amount of credit and interest rate risk we may take.

Although our securities portfolio decreased by \$7,109,000 to \$59,746,000 in 2006, it remains a major part of our asset base. The reduction in the securities portfolio was necessary to fund loan growth. However, more securities were purchased later in the year as loan demand weakened some. With those purchases we sought to lock in current yields

and extend our maturity ladder as a means of protecting ourselves against the negative impact falling interest rates could have. Current indications are that rates may remain stable for some time, nonetheless, our strategy seems to have been prudent as falling rates still appear more likely than rising rates. At year-end the weighted average life of the portfolio was still short at 1.93 years while the weighted average yield was 4.05%. We expect to extend the life of the portfolio and increase the yield by altering our security mix as opportunities allow in 2007.

Because our securities portfolio is classified as available for sale it is carried at fair value. Unrealized losses that are temporary in nature are recognized as an adjustment to equity. Losses determined to be other than temporary are recognized in income. With interest rates stabilizing in 2006 the amount of net unrealized losses fell to \$611,000. Because rates have stabilized the majority of our unrealized losses have been carried for more than twelve months as shown in Note 4. With the exception of one local municipal obligation, all of the issuers carry credit ratings of good to exceptional. Based on this, and our ability and intent to hold the securities for a reasonable period of time sufficient for a full recovery of our investment, we do not consider these investments to be other than temporarily impaired at December 31, 2006.

Our short-term investments include federal funds sold and an interest bearing demand account with the Federal Home Loan Bank of Pittsburgh. These accounts are used for overnight investing in cases when excess liquidity exists. We attempt to limit the amount of these excess funds by staying fully invested in loans or securities. For 2006 our average balance in overnight funds was \$1,377,000 and produced a yield of 4.99%.

### Deposits and Other Funding Sources

Total deposits increased \$6,058,000 to \$196,543,000 in 2006. Included in this is approximately \$4.3 million which was transferred from short-term borrowings. We also benefited as approximately \$8 million of deposits which we expected to be short-term in nature were retained in the deposit base.

Noninterest bearing deposits totaled \$27,103,000 at year-end, down from \$28,468,000 at the end of 2005. The 2005 data, however, was higher than typical at that time. When that is factored in, we can conclude our noninterest bearing deposits were quite stable in 2006.

We experienced a significant amount of rate competition during the rising interest rate cycle which ended in June and, since that time, a number of our competitors have continued to price aggressively. Still, our interest bearing deposits increased by \$7,602,000 in 2006 to \$169,440,000. Growth totaled \$3,302,000 after adjusting for the transfer from short-term borrowings.

This growth was centered in certificates of deposit where we, like many others, utilized selective pricing to gain market share. Total CDs increased \$14,110,000 to \$98,947,000. Other types of interest bearing deposits, such as savings and interest bearing checking, decreased in 2006 as customers sought higher yields. With interest rates expected to remain generally steady in 2007, these trends may continue.

We have utilized short-term borrowings in the form of repurchase agreements to fund operations for a number of years. These agreements typically involve local governmental units such as school districts or area businesses seeking higher yields. They are usually put out for bid annually and local banks compete aggressively for them. We feel that we maintain a competitive advantage by meeting the operational requirements that the agreements frequently contain; nonetheless, risk of losing these funds does exist. At year-end repurchase agreements were \$15,970,000.

In the event this funding source were to be reduced we have several other funding options including a line of credit with the Federal Home Loan Bank of Pittsburgh and federal funds purchased through our other correspondent banks. Borrowings of this nature totaled \$3,863,000 at year-end and averaged \$2,768,000 during the year. As a member of the FHLB we have access to a variety of other funding products as well. For example, on occasion we match fund certain loans with FHLB products. Although we did not acquire any such long-term match funding in 2006, we do have long-term FHLB borrowings in the amount of \$3,512,000. Our total borrowing capacity with the FHLB exceeds \$105 million. Generally, however, we expect to continue to fund our activities through internal sources.

### Capital Resources

Our total capital of \$20.3 million, or 8.3% of assets increased \$665,000 in 2006. We believe this level of capital, as well as our capital structure, is adequate to support current and anticipated future operations. A complete analysis of our capital accounts is provided in the accompanying Statement of Changes in Shareholders' Equity.

Banks and bank holding companies are subject to several risk weighted capital measures. As detailed in Note 14, we continue to maintain capital levels well in excess of the amount needed to be considered well capitalized under the

regulations. This should continue to be the case throughout the foreseeable future and we are not aware of any trends or uncertainties which are expected to materially impair our capital position.

More than the amount or adequacy of our capital, the structure of our capital base changed in 2006. In April, shareholders received a stock split in the form of a 200% stock dividend. Shareholders also approved an increase in the number of authorized shares from 2,250,000 to 4,500,000 to accommodate future growth.

Trading activity in the stock continues to be light with 128,900 shares trading in 2006, including 24,460 treasury shares. The price per share, which was \$19.50 at year-end, is certainly more affordable than the pre-split levels which approximated \$54.00. The stock continues to trade on the over the counter market under the symbol CIWV.OB.

#### Off-Balance-Sheet Obligations

A discussion of our involvement in off-balance-sheet obligations is presented in Note 13 to the consolidated financial statements contained in this report.

#### Liquidity

The objective of our liquidity management program is to ensure the continuous availability of funds to meet the withdrawal demands of customers, the credit needs of borrowers, and to provide for other operational needs. Liquidity is provided by various sources including unpledged investment securities, federal funds sold, loan repayments, a stable and growing deposit base and, when necessary, external borrowings.

We monitor liquidity on a regular basis by preparing projected balance sheets and analyzing our sources and uses of funds. Historically, we have satisfied our liquidity needs through internal sources of funds with the exception of certain loans which have been funded by borrowing funds from the Federal Home Loan Bank of Pittsburgh. As noted previously, we have access to approximately \$105,000,000 through various FHLB programs. We are not aware of any trends, commitments, events or uncertainties which may impair our ability to satisfy our operating cash needs.

#### Impact of Inflation

Our financial statements and related data in this report are prepared in conformity with U.S. generally accepted accounting principles which require our financial position and results of operations to be measured in terms of historical dollars except for the available for sale securities portfolio. Consequently, the relative value of money generally is not considered. Nearly all of our assets and liabilities are monetary in nature and, as a result, interest rates and competition in the market area tend to have a more significant impact on performance than the effect of inflation.

However, inflation does affect noninterest expenses such as personnel costs and the cost of services and supplies we use. We attempt to offset such increases by controlling the level of noninterest expenditures and increasing levels of noninterest income. Because inflation has generally been low during the time covered by these financial statements, the impact of inflation on our earnings has not been significant. Although inflation could become a more significant factor, current Federal Reserve policy and economic conditions do not appear to indicate that it will be in the foreseeable future.

#### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The primary form of market risk facing Citizens is interest rate risk. This is the risk that changes in the interest rates earned on loans, securities and other interest earning assets as well as in the interest rates paid on interest bearing liabilities could negatively impact earnings. Some amount of interest rate risk is inherent and appropriate in banking.

We control interest rate risk through our interest rate sensitivity management program, also known as asset/liability management. The objective of this program is to maximize net interest income while minimizing the risk of adverse effects from changing interest rates. This is done by controlling the mix and maturities of interest sensitive assets and liabilities. The bank has established an asset/liability committee, which is comprised of representatives of our lending and deposit functions as well as members of senior management, for this purpose. Our asset/liability committee reports to the Board of Directors. We use several techniques to monitor and control interest rate risk including gap analysis, interest rate shock testing and other forms of simulation modeling.

Gap analysis measures the amount of interest earning assets and interest bearing liabilities that could reprice in a given time period. When more assets could reprice the gap is said to be positive. This is normally beneficial when interest rates rise. When more liabilities can reprice, the gap is negative which is usually good as interest rates fall. Normally, the size of the gap is expressed as a percent of total assets.

We monitor our gap on a monthly basis. As of December 31, 2006, our one year gap was 1.05% of assets which indicates we may benefit from rising interest rates.

Gap analysis is a static measure and does not consider future changes in the volume of rate sensitive assets and liabilities or the possibility that interest rates of various products may not change by the same amount or at the same time. These theoretical weaknesses are partially addressed by our interest rate shock testing program. In rate shock testing, we project the balances in our various interest sensitive assets and liabilities over the next twelve months. Computations are then done to forecast net interest income assuming an immediate and sustained change in interest rates.

The following table shows the estimated change in our net interest income under several different interest rate shock scenarios. All of these results are within our policy limits.

| <u>Change in<br/>Interest Rates<br/>(basis points)</u> | <u>Percent Change<br/>in Net<br/>Interest Income</u> |
|--|--|
| +100   | -0.91%   |
| -100   | -2.04%   |
| +200   | -0.93%   |
| -200   | -1.79%   |
| +300   | -1.02%   |
| -300   | -0.16%   |

These tests indicate our net interest income may fall whether rates increase or decrease. Based on current rate predictions in the marketplace, we expect that rates will remain stable for the next six months and then begin a gradual decline. Due to our current pricing structure, the rates on some of our deposits products, such as savings accounts, cannot fall by as much as 100 basis points. Therefore, in a falling rate environment we may not be able to lower deposit rates as quickly as our loan rates, and as a result the impact may be greater than would normally be expected.

All methods of interest rate risk measurement and management are based on assumptions. Because of this we cannot precisely predict the impact of changes in interest rates on net interest income. Actual results will differ from the simulated results due to the timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the strategies we employ.

**Item 8. Financial Statements and Supplementary Data****CITIZENS FINANCIAL CORP.  
AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS  
December 31, 2006 and 2005**

| <b>ASSETS</b>   | <b>2006</b>                  | <b>2005</b>                  |
|---|------------------------------|------------------------------|
| Cash and due from banks   | \$ 6,064,890                 | \$ 6,770,128                 |
| Interest bearing deposits with other banks  | 29,858                       | 102,608                      |
| Federal funds sold  | -                            | 1,900,000                    |
| Securities available for sale, at fair value  | 59,745,539                   | 66,854,339                   |
| Loans, less allowance for loan losses of \$1,873,038 and \$1,597,006, respectively  | 166,217,889                  | 152,136,327                  |
| Bank premises and equipment, net  | 4,331,313                    | 4,192,060                    |
| Accrued interest receivable   | 1,393,468                    | 1,321,120                    |
| Other assets  | <u>5,197,515</u>             | <u>4,913,386</u>             |
| <b>Total assets</b>   | <b><u>\$ 242,980,472</u></b> | <b><u>\$ 238,189,968</u></b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                              |                              |
| <b>Liabilities</b>  |                              |                              |
| Deposits:   |                              |                              |
| Noninterest bearing   | \$ 27,103,487                | \$ 28,647,792                |
| Interest bearing  | <u>169,439,728</u>           | <u>161,837,937</u>           |
| Total deposits  | 196,543,215                  | 190,485,729                  |
| Short-term borrowings   | 19,833,434                   | 20,511,399                   |
| Long-term borrowings  | 3,511,770                    | 5,145,328                    |
| Other liabilities   | <u>2,814,034</u>             | <u>2,434,207</u>             |
| <b>Total liabilities</b>  | <b><u>222,702,453</u></b>    | <b><u>218,576,663</u></b>    |
| <b>Commitments and contingencies</b>  |                              |                              |
| <b>Shareholders' equity</b>   |                              |                              |
| Common stock, \$2.00 par value, authorized 4,500,000 and 2,250,000 shares,<br>issued 2,250,000 and 750,000 shares, respectively | 4,500,000                    | 1,500,000                    |
| Additional paid-in capital  | -                            | 2,100,000                    |
| Retained earnings   | 20,842,981                   | 20,704,572                   |
| Accumulated other comprehensive income/(loss)   | (1,233,399)                  | (1,315,875)                  |
| Treasury stock at cost, 420,496 and 132,012 shares, respectively  | <u>(3,831,563)</u>           | <u>(3,375,392)</u>           |
| <b>Total shareholders' equity</b>   | <b><u>20,278,019</u></b>     | <b><u>19,613,305</u></b>     |
| <b>Total liabilities and shareholders' equity</b>   | <b><u>\$ 242,980,472</u></b> | <b><u>\$ 238,189,968</u></b> |

**CITIZENS FINANCIAL CORP.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**  
For The Years Ended December 31, 2006, 2005 and 2004

|  | <u>2006</u>         | <u>2005</u>         | <u>2004</u>         |
|--|---------------------|---------------------|---------------------|
| <b>Interest and dividend income</b>                                |                     |                     |                     |
| Interest and fees on loans   | \$ 12,933,850       | \$ 10,744,643       | \$ 9,427,403        |
| Interest and dividends on securities:                              |                     |                     |                     |
| Taxable  | 2,045,639           | 1,780,716           | 1,636,570           |
| Tax-exempt   | 303,154             | 327,325             | 361,190             |
| Interest on interest bearing deposits with other banks             | 48,150              | 59,679              | -                   |
| Interest on federal funds sold                                     | <u>20,514</u>       | <u>63,493</u>       | <u>17,914</u>       |
| <b>Total interest and dividend income</b>                          | <u>15,351,307</u>   | <u>12,975,856</u>   | <u>11,443,077</u>   |
| <b>Interest expense</b>  |                     |                     |                     |
| Interest on deposits   | 4,881,518           | 3,376,537           | 2,645,847           |
| Interest on short-term borrowings                                  | 801,402             | 501,698             | 307,654             |
| Interest on long-term borrowings                                   | <u>173,397</u>      | <u>178,078</u>      | <u>119,649</u>      |
| <b>Total interest expense</b>                                      | <u>5,856,317</u>    | <u>4,056,313</u>    | <u>3,073,150</u>    |
| <b>Net interest income</b>   | 9,494,990           | 8,919,543           | 8,369,927           |
| Provision for loan losses  | <u>423,385</u>      | <u>274,667</u>      | <u>934,899</u>      |
| <b>Net interest income after provision<br/>    for loan losses</b> | <u>9,071,605</u>    | <u>8,644,876</u>    | <u>7,435,028</u>    |
| <b>Noninterest income</b>  |                     |                     |                     |
| Trust income   | 207,178             | 201,402             | 194,593             |
| Service fees   | 851,526             | 771,831             | 700,732             |
| Insurance commissions  | 37,069              | 42,810              | 41,155              |
| Securities gains/(losses), net                                     | (17,694)            | -                   | 23,185              |
| Brokerage fees   | 117,207             | 79,117              | 50,034              |
| Secondary market loan fees   | 108,382             | 101,523             | 62,691              |
| Other  | <u>326,338</u>      | <u>271,639</u>      | <u>320,818</u>      |
| <b>Total noninterest income</b>                                    | <u>1,630,006</u>    | <u>1,468,322</u>    | <u>1,393,208</u>    |
| <b>Noninterest expense</b>   |                     |                     |                     |
| Salaries and employee benefits                                     | 3,925,985           | 3,723,480           | 3,591,142           |
| Net occupancy expense  | 383,900             | 332,748             | 265,313             |
| Equipment expense  | 439,193             | 484,001             | 480,443             |
| Data processing  | 524,304             | 598,824             | 559,238             |
| Director fees  | 272,880             | 252,483             | 220,861             |
| Postage expense  | 182,136             | 170,653             | 166,589             |
| Professional service fees  | 349,574             | 245,714             | 159,251             |
| Stationery   | 152,549             | 155,923             | 162,858             |
| Software expense   | 182,608             | 208,231             | 174,774             |
| Other  | <u>1,245,945</u>    | <u>966,597</u>      | <u>964,490</u>      |
| <b>Total noninterest expense</b>                                   | <u>7,659,074</u>    | <u>7,138,654</u>    | <u>6,744,959</u>    |
| <b>Income before income taxes</b>                                  | 3,042,537           | 2,974,544           | 2,083,277           |
| Income tax expense   | <u>955,646</u>      | <u>927,358</u>      | <u>426,938</u>      |
| <b>Net income</b>  | <u>\$ 2,086,891</u> | <u>\$ 2,047,186</u> | <u>\$ 1,656,339</u> |
| <b>Basic and fully diluted earnings per common share*</b>          | <u>\$ 1.13</u>      | <u>\$ 1.10</u>      | <u>\$ 0.88</u>      |
| <b>Basic and fully diluted average common shares outstanding*</b>  | <u>1,842,662</u>    | <u>1,864,215</u>    | <u>1,886,631</u>    |

\*Restated to reflect stock split in the form of a 200% stock dividend declared in March 2006.

See Notes to Consolidated Financial Statements

**CITIZENS FINANCIAL CORP.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
For The Years Ended December 31, 2006, 2005 and 2004

|  | <u>2006</u>         | <u>2005</u>        | <u>2004</u>         |
|--|---------------------|--------------------|---------------------|
| <b>Net Income</b>  | \$ 2,086,891        | \$ 2,047,186       | \$ 1,656,339        |
| Other comprehensive income/(loss):   |                     |                    |                     |
| Gross unrealized gains/(losses) arising during the period  | 338,294             | (1,060,150)        | (972,022)           |
| Adjustment for income tax (benefit)/expense  | <u>(128,552)</u>    | <u>402,857</u>     | <u>369,368</u>      |
|  | <u>209,742</u>      | <u>(657,293)</u>   | <u>(602,654)</u>    |
| Reclassification adjustment for (gains)/losses<br>included in net income   | 17,694              | -                  | (23,185)            |
| Adjustment for income tax (benefit)/expense  | <u>(6,724)</u>      | <u>-</u>           | <u>8,810</u>        |
|  | <u>10,970</u>       | <u>-</u>           | <u>(14,375)</u>     |
| Increase in minimum pension liability  | -                   | (1,155,756)        | -                   |
| Adjustment for income tax benefit  | <u>-</u>            | <u>439,187</u>     | <u>-</u>            |
|  | <u>-</u>            | <u>(716,569)</u>   | <u>-</u>            |
| Adjustment to apply statement of financial accounting<br>standard no. 158 to the employee pension and other<br>postretirement benefits | (222,964)           | -                  | -                   |
| Adjustment for income tax benefit  | <u>84,728</u>       | <u>-</u>           | <u>-</u>            |
|  | <u>(138,236)</u>    | <u>-</u>           | <u>-</u>            |
| Other comprehensive income/(loss), net of tax  | <u>82,476</u>       | <u>(1,373,862)</u> | <u>(617,029)</u>    |
| <b>Comprehensive Income</b>  | <u>\$ 2,169,367</u> | <u>\$ 673,324</u>  | <u>\$ 1,039,310</u> |

See Notes to Consolidated Financial Statements

**CITIZENS FINANCIAL CORP.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
For the Years Ended December 31, 2006, 2005 and 2004

|  | <u>Common Stock</u> |                     | <u>Additional<br/>Paid-In<br/>Capital</u> | <u>Retained<br/>Earnings</u> | <u>Accumulated<br/>Other<br/>Compre-<br/>hensive<br/>Income/(Loss)</u> | <u>Treasury<br/>Stock</u> | <u>Total<br/>Share-<br/>holders'<br/>Equity</u> |
|--|---------------------|---------------------|---|------------------------------|--|---------------------------|---|
|  | <u>Shares</u>       | <u>Amount</u>       |   |                              |  |                           |   |
| <b>Balance, December 31, 2003</b>                            | <u>750,000</u>      | <u>\$ 1,500,000</u> | <u>\$ 2,100,000</u>                       | <u>\$18,965,862</u>          | <u>\$ 675,016</u>  | <u>\$ (2,762,464)</u>     | <u>\$20,478,414</u>                             |
| Net income   | -                   | -                   | -   | 1,656,339                    | -  | -                         | 1,656,339                                       |
| Cost of 7,465 shares acquired<br>as treasury stock           | -                   | -                   | -   | -                            | -  | (322,854)                 | (322,854)                                       |
| Cash dividends declared<br>(\$0.52 per share)                | -                   | -                   | -   | (972,089)                    | -  | -                         | (972,089)                                       |
| Net change other comprehensive income                        | -                   | -                   | -   | -                            | (617,029)  | -                         | (617,029)                                       |
| <b>Balance, December 31, 2004</b>                            | <u>750,000</u>      | <u>1,500,000</u>    | <u>2,100,000</u>                          | <u>19,650,112</u>            | <u>57,987</u>  | <u>(3,085,318)</u>        | <u>20,222,781</u>                               |
| Net income   | -                   | -                   | -   | 2,047,186                    | -  | -                         | 2,047,186                                       |
| Cost of 5,925 shares acquired<br>as treasury stock           | -                   | -                   | -   | -                            | -  | (290,074)                 | (290,074)                                       |
| Cash dividends declared<br>(\$0.53 per share)                | -                   | -                   | -   | (992,726)                    | -  | -                         | (992,726)                                       |
| Net change other comprehensive income                        | -                   | -                   | -   | -                            | (1,373,862)  | -                         | (1,373,862)                                     |
| <b>Balance, December 31, 2005</b>                            | <u>750,000</u>      | <u>1,500,000</u>    | <u>2,100,000</u>                          | <u>20,704,572</u>            | <u>(1,315,875)</u>   | <u>(3,375,392)</u>        | <u>19,613,305</u>                               |
| Net income   | -                   | -                   | -   | 2,086,891                    | -  | -                         | 2,086,891                                       |
| Cost of 24,460 shares acquired<br>as treasury stock          | -                   | -                   | -   | -                            | -  | (456,171)                 | (456,171)                                       |
| Cash dividends declared<br>(\$0.57 per share)                | -                   | -                   | -   | (1,048,482)                  | -  | -                         | (1,048,482)                                     |
| Net change other comprehensive income                        | -                   | -                   | -   | -                            | 82,476   | -                         | 82,476  |
| Stock split effected in the form<br>of a 200% stock dividend | <u>1,500,000</u>    | <u>3,000,000</u>    | <u>(2,100,000)</u>                        | <u>(900,000)</u>             | <u>-</u>   | <u>-</u>                  | <u>-</u>  |
| <b>Balance, December 31, 2006</b>                            | <u>2,250,000</u>    | <u>\$ 4,500,000</u> | <u>\$ -</u>                               | <u>\$20,842,981</u>          | <u>\$ (1,233,399)</u>  | <u>\$ (3,831,563)</u>     | <u>\$20,278,019</u>                             |

See Notes to Consolidated Financial Statements

**CITIZENS FINANCIAL CORP.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2006, 2005 and 2004

|   | <u>2006</u>        | <u>2005</u>         | <u>2004</u>        |
|---|--------------------|---------------------|--------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                    |                     |                    |
| Net income  | \$ 2,086,891       | \$ 2,047,186        | \$ 1,656,339       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                    |                     |                    |
| Depreciation and amortization   | 351,942            | 414,395             | 417,728            |
| Provision for loan losses   | 423,385            | 274,667             | 934,899            |
| Deferred income tax expense   | (122,232)          | (202,424)           | 66,829             |
| Amortization of security premiums, net of accretion of security discounts         | 68,272             | 196,484             | 281,443            |
| Securities (gains)/losses, net  | 17,694             | -                   | (23,185)           |
| Gain on sale of bank premises   | (31,877)           | -                   | -                  |
| (Gain)/loss on sale of equipment and other assets                                 | 80,184             | (16,787)            | (24,053)           |
| Increase in accrued interest receivable   | (72,348)           | (202,621)           | (22,013)           |
| Increase in other assets  | (3,187)            | (257,428)           | (473,268)          |
| Increase in other liabilities   | 156,863            | 874,896             | 349,015            |
|   | <u>2,955,587</u>   | <u>3,128,368</u>    | <u>3,163,734</u>   |
| <b>Net cash provided by operating activities</b>                                  |                    |                     |                    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                    |                     |                    |
| Proceeds from sales of securities available for sale                              | 3,800,409          | 522,200             | 2,382,766          |
| Proceeds from maturities and calls of securities available for sale               | 14,461,000         | 9,190,545           | 16,636,865         |
| Principal payments received on securities available for sale                      | 1,963,218          | 2,388,713           | 2,914,405          |
| Purchases of securities available for sale  | (12,845,805)       | (26,338,022)        | (16,148,868)       |
| Loans made to customers, net  | (15,434,051)       | (8,290,615)         | (12,375,235)       |
| Purchases of bank premises and equipment  | (483,919)          | (380,311)           | (1,032,823)        |
| Proceeds from sale of bank premises   | 38,000             | -                   | -                  |
| Proceeds from sale of other real estate and other assets                          | 626,263            | 173,443             | 443,313            |
| Purchase of real estate   | -                  | -                   | (105,000)          |
|   | <u>(7,874,885)</u> | <u>(22,734,047)</u> | <u>(7,284,577)</u> |
| <b>Net cash used in investing activities</b>                                      |                    |                     |                    |

See Notes to Consolidated Financial Statements  
(Continued)

**CONSOLIDATED STATEMENTS OF CASH FLOWS - Continued**  
**For the Years Ended December 31, 2006, 2005 and 2004**

|  | <u>2006</u>         | <u>2005</u>           | <u>2004</u>         |
|--|---------------------|-----------------------|---------------------|
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                |                     |                       |                     |
| Net increase in demand deposit, NOW, money market and savings accounts     | (8,052,575)         | 17,294,294            | 1,438,095           |
| Net increase in time deposits  | 14,110,061          | 7,890,783             | 2,314,008           |
| Net increase/(decrease) in short-term borrowings                           | (677,965)           | (1,998,756)           | 443,854             |
| Proceeds from long-term borrowings   | -                   | 3,500,000             | 3,100,000           |
| Repayments of long-term borrowings   | (1,633,558)         | (2,500,904)           | (2,356,670)         |
| Dividends paid   | (1,048,482)         | (992,726)             | (972,089)           |
| Acquisition of treasury stock  | (456,171)           | (290,074)             | (322,854)           |
| <b>Net cash provided by financing activities</b>                           | <u>2,241,310</u>    | <u>22,902,617</u>     | <u>3,644,344</u>    |
| Increase/(decrease) in cash and cash equivalents                           | (2,677,988)         | 3,296,938             | (476,499)           |
| <b>Cash and cash equivalents:</b>  |                     |                       |                     |
| Beginning  | <u>8,772,736</u>    | <u>5,475,798</u>      | <u>5,952,297</u>    |
| Ending   | <u>\$ 6,094,748</u> | <u>\$ 8,772,736</u>   | <u>\$ 5,475,798</u> |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>                   |                     |                       |                     |
| Cash payments for:   |                     |                       |                     |
| Interest on deposits and on other borrowings                               | <u>\$ 5,678,421</u> | <u>\$ 3,967,023</u>   | <u>\$ 3,095,290</u> |
| Income taxes   | <u>\$ 1,311,957</u> | <u>\$ 940,784</u>     | <u>\$ 647,834</u>   |
| <b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES</b> |                     |                       |                     |
| Other real estate and other assets acquired in settlement of loans         | <u>\$ 929,104</u>   | <u>\$ 466,445</u>     | <u>\$ 329,000</u>   |
| Unrealized gain/(loss) on securities available for sale                    | <u>\$ 355,988</u>   | <u>\$ (1,060,150)</u> | <u>\$ (995,207)</u> |

## Notes to Consolidated Financial Statements

### Note 1. Significant Accounting Policies

**Nature of Business:** Citizens Financial Corp. (“Citizens” or “the company” or “we”) was incorporated as a bank holding company in 1987. Our wholly-owned bank subsidiary, Citizens National Bank of Elkins (“the bank”) provides retail and commercial loan, deposit, trust and brokerage services to customers in Randolph, Tucker, Grant and Pocahontas Counties of West Virginia and nearby areas.

**Basis of Financial Statement Presentation:** Our accounting and reporting policies conform to U.S. generally accepted accounting principles and to general practices within the banking industry.

**Use of Estimates:** In preparing consolidated financial statements in conformity with U.S. generally accepted accounting principles, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheets and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets.

**Principles of Consolidation:** The accompanying consolidated financial statements include the accounts of Citizens Financial Corp. and its wholly-owned subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Presentation of Cash Flows:** For purposes of reporting cash flows, cash and cash equivalents includes cash on hand, balances due from banks (including cash items in process of clearing) and federal funds sold. Cash flows from demand deposits, NOW accounts and savings accounts are reported net since their original maturities are less than three months. Cash flows from loans and certificates of deposit and other time deposits are also reported net.

**Securities:** All of our debt and equity investment securities are classified as available-for-sale and carried at fair value, with unrealized gains and losses, net of tax, reported as a separate component of comprehensive income until realized. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method. Premiums and discounts are recognized as interest income using the interest method over the period to maturity. Declines in the fair value of available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, we consider (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**Loans and Allowance for Loan Losses:** The bank makes mortgage, commercial and consumer loans to customers. Loans which management has the intent and ability to hold for the foreseeable future or until maturity or payoff are generally reported at their outstanding principal balance reduced by unearned income and the allowance for loan losses. Interest income is accrued daily on the outstanding principal balance. Loan origination fees and certain direct loan origination costs are deferred and amortized as adjustments to the related loan’s yield over its contractual life.

The accrual of interest on loans is discontinued when they are 90 days delinquent unless the loan is well secured and in the process of collection. However, loans may be placed on nonaccrual, or charged-off, at an earlier date if the collection of principal and interest is doubtful. When loans are placed on nonaccrual all interest which has accrued but not been collected is reversed against interest income, unless the income was recognized in prior years in which case it is charged to the allowance for loan losses. After loans are placed on nonaccrual, interest is recognized on the cash basis. Loans may be returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that are inherent in the loan portfolio. The allowance is established by provisions charged to operating expense and reduced when loans are charged-off. Subsequent recoveries, if any, are credited to the allowance.

Management’s evaluation of the adequacy of the allowance for loan losses is based upon quarterly assessments of the loan portfolio. This assessment is inherently subjective and requires significant estimates that are subject to revisions as more information becomes available. Among the factors we consider are the borrower’s ability to repay, the value of

the collateral securing the loan, historical charge-off and delinquency trends, current economic and business conditions, lending policies and procedures, concentrations of credit, and various other factors.

A loan is considered impaired when, based on current information and events, it is probable that the company will be unable to collect the scheduled payments when due according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls 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 reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for larger, nonhomogeneous loans including commercial and construction loans. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the bank does not separately identify individual consumer and residential loans for impairment disclosures.

The allowance consists of a specific component which relates to larger loans classified as special mention, substandard or doubtful and are specifically evaluated for impairment, as well as a general component for the smaller homogeneous loans not specifically evaluated. For specifically evaluated loans considered impaired an allowance is established when the loans' discounted cash flows, collateral value or observable market price is less than its carrying value. For loans which are evaluated but not considered impaired, as well as smaller homogeneous loans, an allowance is established by grouping the loans into pools having similar risk characteristics and applying historical loan factors, adjusted for current conditions, to each pool.

**Bank Premises and Equipment:** Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily by the straight-line method over the estimated useful lives of the assets. Premises and equipment typically have useful lives ranging from 5 to 39 years. Repairs and maintenance expenditures are charged to operating expense as incurred. Major improvements and additions to premises and equipment are capitalized.

**Other Real Estate:** Other real estate consists of real estate held for resale which is acquired through foreclosure on loans secured by such real estate. At the time of acquisition, these properties are recorded at fair value with any writedown charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Expenses incurred in connection with operating these properties are charged to operating expenses as incurred; depreciation is not recorded on property held for sale. Gains and losses on the sales of these properties are credited or charged to operating income in the year of the transaction.

**Intangible Assets:** Intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in a combination with a related contract, asset, or liability. Intangible assets are tested at least annually for impairment.

**Securities Sold Under Agreements to Repurchase:** We generally account for securities sold under agreements to repurchase as collateralized financing transactions. Securities pledged as collateral under these financing arrangements cannot be sold or repledged by the secured party.

**Pension Benefits:** The bank has a noncontributory, defined benefit pension plan covering substantially all employees. The plan provides benefits that are based on employees' five year average final compensation and years of service. Our funding policy is to make annual contributions as permitted or required by regulation. Pension costs are actuarially determined and charged to expense.

**Postretirement Benefits:** The bank also provides certain health care and life insurance benefits for all retired employees that meet certain eligibility requirements. The bank's share of the estimated costs that will be paid after retirement is generally being accrued by charges to expense over the employees' active service periods to the dates they are fully eligible for benefits.

**Income Taxes:** Deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Valuation allowances are established when deemed necessary to reduce deferred tax assets to the amount expected to be realized.

**Basic and Fully Diluted Earnings per Share:** Basic and fully diluted earnings per common share is computed based upon the weighted average shares outstanding. The weighted average shares outstanding were 1,842,662, 1,864,215 and 1,886,631 for the years ended December 31, 2006, 2005 and 2004, respectively, after considering the stock split outlined in Note 2. We did not have any potentially dilutive securities during that time.

**Trust Department:** Assets held in an agency or fiduciary capacity by the bank's trust department are not assets of the bank and are not included in the accompanying consolidated balance sheets.

**Off-Balance-Sheet Credit Related Financial Instruments.** In the ordinary course of business, we may enter into commitments to extend credit, including commercial letters of credit, and standby letters of credit. These financial instruments are recorded when they are funded.

**Derivative Instruments and Hedging Activities:** The bank recognizes all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

**Advertising:** Advertising costs are expensed as they are incurred.

**Reclassifications:** Certain accounts in the consolidated financial statements for 2005 and 2004, as previously presented, have been reclassified to conform to current year classifications.

**Significant New Accounting Pronouncements:** In September 2006, the Securities and Exchange Commission (SEC) released Staff Accounting Bulletin No. 108 (SAB 108). SAB 108 expresses the SEC staff's views regarding the process of quantifying financial statement misstatements. SAB 108 expresses the SEC staff's view that a registrant's materiality evaluation of an identified unadjusted error should quantify the effects of the error on each financial statement and related financial statement disclosures and that prior year misstatements should be considered in quantifying misstatements in current year financial statements. SAB 108 also states that correcting prior year financial statements for immaterial errors would not require previously filed reports to be amended. Such correction may be made the next time the registrant files the prior year financial statements. The cumulative effect of the initial application should be reported in the carrying amounts of assets and liabilities as of the beginning of that fiscal year and the offsetting adjustment should be made to the opening balance of retained earnings for that year. Registrants should disclose the nature and amount of each individual error being corrected in the cumulative adjustment. The SEC staff encourages early application of the guidance in SAB 108 for interim periods of the first fiscal year ending after November 15, 2006. The company does not expect the implementation of SAB 108 to have a material impact on its financial condition or results of operations.

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140" (SFAS 155). SFAS 155 permits fair value measurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. The Statement also clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133. It establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. SFAS 155 also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The company does not expect the implementation of SFAS 155 to have a material impact on its financial condition or results of operations.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, "Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140" (SFAS 156). SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into certain servicing contracts. The Statement also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 permits an entity to choose between the amortization and fair value methods for subsequent measurements. At initial adoption, the Statement permits a one-time reclassification of available for sale securities to trading securities by entities with recognized servicing rights. SFAS 156 also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. This Statement is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The

company does not expect the implementation of SFAS 156 to have a material impact on its financial condition or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but may change current practice for some entities. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The company does not expect the implementation of SFAS 157 to have a material impact on its financial condition or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS 158). SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The funded status of a benefit plan will be measured as the difference between plan assets at fair value and the benefit obligation. For a pension plan, the benefit obligation is the projected benefit obligation. For any other postretirement plan, the benefit obligation is the accumulated postretirement benefit obligation. SFAS 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. The Statement also requires additional disclosure in the notes to financial statements about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. The company is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. The company has included the impact of this implementation in the consolidated financial statements contained in this report. The requirement to measure plan assets and benefit obligations as of the date of the employers' fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. This change in the measurement date will not have a material impact on the company's financial condition or results of operations.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS 109. The Interpretation prescribes a recognition threshold and measurement principles for the financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return that are not certain to be realized. FIN 48 is effective for fiscal years beginning after December 15, 2006. The company does not expect the implementation of FIN 48 to have a material impact on its financial condition or results of operations.

In September 2006, the Emerging Issues Task Force issued EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." This consensus concludes that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with FASB Statement No. 106 (if, in substance, a postretirement benefit plan exists) or APB Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The consensus is effective for fiscal years beginning after December 15, 2007. The company is currently evaluating the effect that EITF No. 06-4 will have on its consolidated financial statements when implemented.

In September 2006, The Emerging Issues Task Force issued EITF 06-5, "Accounting for Purchases of Life Insurance-Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4." This consensus concludes that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. A consensus also was reached that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). The consensus are effective for fiscal years beginning after December 15, 2006. The company is currently evaluating the effect that EITF No. 06-5 will have on its consolidated financial statements when implemented.

## **Note 2. Declaration of Stock Split**

On March 7, 2006 Citizens board of directors declared a stock split which was paid on April 14, 2006 in the form of a 200% stock dividend to shareholders of record April 3, 2006. The primary reason for doing so was to reduce the share

price of the stock in an effort to improve its liquidity. Citizens stock, which is neither widely held nor widely traded, is an over the counter bulletin board stock with the symbol CIWV.OB.

Distribution of this stock dividend required the use of all authorized shares. On April 22, 2006 the shareholders authorized an additional 2,250,000 shares for future use.

### Note 3. Restrictions on Cash and Amounts Due from Banks

At December 31, 2006 we had cash concentrations totaling \$3,693,080 with the Federal Reserve Bank of Richmond. These funds, as well as deposits with other correspondent banks, are generally unsecured and have limited insurance under current banking insurance regulations.

### Note 4. Securities

The amortized cost, unrealized gains, unrealized losses and estimated fair values of securities at December 31, 2006 and 2005, are summarized below. All such securities are available for sale.

|  | <b>2006</b>               |                   |                   | <b>Carrying<br/>Value<br/>(Estimated<br/>Fair<br/>Value)</b> |
|--|---------------------------|-------------------|-------------------|--|
|  | <b>Amortized<br/>Cost</b> | <b>Unrealized</b> |                   |  |
|  |                           | <b>Gains</b>      | <b>Losses</b>     |  |
| U.S. Government agencies and corporations                              | \$ 41,920,556             | \$ 5,227          | \$ 414,829        | \$ 41,510,954  |
| Mortgage backed securities - U.S. Government agencies and corporations | 8,374,473                 | 299               | 148,911           | 8,225,861  |
| Federal Reserve Bank stock, restricted                                 | 108,000                   | -                 | -                 | 108,000  |
| Federal Home Loan Bank stock, restricted                               | 770,200                   | -                 | -                 | 770,200  |
| Tax exempt state and political subdivisions                            | <u>9,182,944</u>          | <u>16,081</u>     | <u>68,501</u>     | <u>9,130,524</u>   |
| Total securities available for sale                                    | <u>\$ 60,356,173</u>      | <u>\$ 21,607</u>  | <u>\$ 632,241</u> | <u>\$ 59,745,539</u>   |

|  | <b>2005</b>               |                   |                     | <b>Carrying<br/>Value<br/>(Estimated<br/>Fair<br/>Value)</b> |
|--|---------------------------|-------------------|---------------------|--|
|  | <b>Amortized<br/>Cost</b> | <b>Unrealized</b> |                     |  |
|  |                           | <b>Gains</b>      | <b>Losses</b>       |  |
| U.S. Government agencies and corporations                              | \$ 50,560,587             | \$ 4,296          | \$ 718,899          | \$ 49,845,984  |
| Mortgage backed securities - U.S. Government agencies and corporations | 7,005,422                 | 947               | 203,662             | 6,802,707  |
| Federal Reserve Bank stock, restricted                                 | 108,000                   | -                 | -                   | 108,000  |
| Federal Home Loan Bank stock, restricted                               | 596,200                   | -                 | -                   | 596,200  |
| Corporate debt securities  | 1,270,501                 | -                 | 19,476              | 1,251,025  |
| Tax exempt state and political subdivisions                            | <u>8,280,250</u>          | <u>34,744</u>     | <u>64,571</u>       | <u>8,250,423</u>   |
| Total securities available for sale                                    | <u>\$ 67,820,960</u>      | <u>\$ 39,987</u>  | <u>\$ 1,006,608</u> | <u>\$ 66,854,339</u>   |

The tables which follow provide summaries of securities which were in an unrealized loss position at December 31, 2006 and 2005, all of which are available for sale. As of December 31, 2006, these securities had a total fair value of \$55,092,401 and carried unrealized losses of \$632,241 or 1.15%. Securities which have been in a continuous loss position for the past twelve months total \$42,536,662. The unrealized loss pertaining to these securities is \$590,749 or 1.39%. The majority of these losses are on securities issued by U.S. government agencies and corporations which carry the implied faith and credit of the U.S. Government. The other losses are on municipal instruments. With the exception of one municipal which is not rated, all of these instruments carry A ratings from the major credit rating agencies. We believe that these unrealized losses are the result of changing interest rates and that, along with our intent and ability to hold these

investments to maturity, provide strong evidence that we will fully recover our investment. In addition, no losses have been recognized on the \$58,795,734 of securities that carried unrealized losses at December 31, 2005.

| <b>2006</b>  |                             |                          |                            |                          |                             |                          |
|--|-----------------------------|--------------------------|----------------------------|--------------------------|-----------------------------|--------------------------|
|  | <u>Less Than 12 Months</u>  |                          | <u>12 Months or More</u>   |                          | <u>Total</u>                |                          |
|  | <u>Fair Value</u>           | <u>Unrealized Losses</u> | <u>Fair Value</u>          | <u>Unrealized Losses</u> | <u>Fair Value</u>           | <u>Unrealized Losses</u> |
| U.S. Government agencies and corporations                              | \$ 5,332,240                | \$ 13,677                | \$33,264,044               | \$401,152                | \$ 38,596,284               | \$ 414,829               |
| Mortgage backed securities - U.S. Government agencies and corporations | 2,782,873                   | 9,857                    | 5,327,723                  | 139,054                  | 8,110,596                   | 148,911                  |
| Tax exempt state and political subdivisions                            | <u>3,440,626</u>            | <u>17,958</u>            | <u>3,944,895</u>           | <u>50,543</u>            | <u>7,385,521</u>            | <u>68,501</u>            |
| <b>Total</b>   | <b><u>\$ 11,555,739</u></b> | <b><u>\$ 41,492</u></b>  | <b><u>\$42,536,662</u></b> | <b><u>\$590,749</u></b>  | <b><u>\$ 55,092,401</u></b> | <b><u>\$ 632,241</u></b> |

  

| <b>2005</b>  |                             |                          |                            |                          |                             |                           |
|--|-----------------------------|--------------------------|----------------------------|--------------------------|-----------------------------|---------------------------|
|  | <u>Less Than 12 Months</u>  |                          | <u>12 Months or More</u>   |                          | <u>Total</u>                |                           |
|  | <u>Fair Value</u>           | <u>Unrealized Losses</u> | <u>Fair Value</u>          | <u>Unrealized Losses</u> | <u>Fair Value</u>           | <u>Unrealized Losses</u>  |
| U.S. Government agencies and corporations                              | \$ 26,648,724               | \$258,255                | \$19,810,150               | \$460,644                | \$ 46,458,874               | \$ 718,899                |
| Mortgage backed securities - U.S. Government agencies and corporations | 3,282,560                   | 71,703                   | 3,397,060                  | 131,959                  | 6,679,620                   | 203,662                   |
| Corporate debt securities  | -                           | -                        | 1,251,025                  | 19,476                   | 1,251,025                   | 19,476                    |
| Tax exempt state and political subdivisions                            | <u>3,454,558</u>            | <u>41,636</u>            | <u>951,657</u>             | <u>22,935</u>            | <u>4,406,215</u>            | <u>64,571</u>             |
| <b>Total</b>   | <b><u>\$ 33,385,842</u></b> | <b><u>\$371,594</u></b>  | <b><u>\$25,409,892</u></b> | <b><u>\$635,014</u></b>  | <b><u>\$ 58,795,734</u></b> | <b><u>\$1,006,608</u></b> |

The maturities, amortized cost and estimated fair values of securities at December 31, 2006 are summarized as follows:

|                                  | <u>Amortized Cost</u>       | <u>Carrying Value (Estimated Fair Value)</u> |
|----------------------------------|-----------------------------|--|
| Due within one year              | \$ 19,678,168               | \$ 19,510,619                                |
| Due after one through five years | 38,854,752                  | 38,420,693                                   |
| Due after five through ten years | 945,053                     | 936,027                                      |
| Equity securities                | <u>878,200</u>              | <u>878,200</u>                               |
| <b>Total</b>                     | <b><u>\$ 60,356,173</u></b> | <b><u>\$ 59,745,539</u></b>                  |

Mortgage backed securities have remaining contractual maturities ranging from 1 day to 14.25 years and are reflected in the maturity distribution schedule based on their anticipated average life to maturity, which ranges from 0.04 to 5.28 years. Accordingly, discounts are accreted and premiums are amortized over the anticipated life to maturity of the specific obligation.

The proceeds from sales, calls and maturities of securities, including principal payments received on mortgage backed securities, and the related gross gains and losses realized are as follows:

| <u>Years Ended December 31,</u> | <u>Proceeds From</u>       |                             |                            | <u>Gross Realized</u> |                         |
|---------------------------------|----------------------------|-----------------------------|----------------------------|-----------------------|-------------------------|
|                                 | <u>Sales</u>               | <u>Calls and Maturities</u> | <u>Principal Payments</u>  | <u>Gains</u>          | <u>Losses</u>           |
| <b>2006</b>                     | <b><u>\$ 3,800,409</u></b> | <b><u>\$ 14,461,000</u></b> | <b><u>\$ 1,963,218</u></b> | <b><u>\$ -</u></b>    | <b><u>\$ 17,694</u></b> |

|             |                     |                      |                     |                  |                  |
|-------------|---------------------|----------------------|---------------------|------------------|------------------|
| <b>2005</b> | <u>\$ 522,200</u>   | <u>\$ 9,190,545</u>  | <u>\$ 2,388,713</u> | <u>\$ -</u>      | <u>\$ -</u>      |
| <b>2004</b> | <u>\$ 2,382,766</u> | <u>\$ 16,636,865</u> | <u>\$ 2,914,405</u> | <u>\$ 36,783</u> | <u>\$ 13,598</u> |

At December 31, 2006 and 2005 securities with amortized costs of \$30,807,634 and \$28,427,321, respectively, and estimated fair values of \$30,448,915 and \$27,983,015, respectively, were pledged to secure public deposits, securities sold under agreements to repurchase, and for other purposes required or permitted by law.

Federal Reserve Bank stock and Federal Home Loan Bank stock are equity securities which are included in securities available for sale in the accompanying consolidated financial statements. Such securities are carried at cost, since they may only be sold back to the respective issuer or another member at par value.

#### Note 5. Loans

Loans are summarized as follows:

|  | <b>December 31,</b>   |                       |
|--|-----------------------|-----------------------|
|  | <b>2006</b>           | <b>2005</b>           |
| Commercial, financial and agricultural       | \$ 26,968,995         | \$ 26,589,047         |
| Real estate – construction                   | 13,964,500            | 10,559,207            |
| Real estate – home equity                    | 7,985,253             | 8,796,427             |
| Real estate – residential mortgage           | 61,401,473            | 55,127,595            |
| Real estate – commercial mortgage            | 45,578,979            | 40,944,311            |
| Installment loans                            | 10,634,857            | 9,725,720             |
| Other  | 1,611,149             | 2,051,144             |
| Total loans                                  | <u>168,145,206</u>    | <u>153,793,451</u>    |
| Less:  |                       |                       |
| Allowance for loan losses                    | 1,873,038             | 1,597,006             |
| Net deferred loan origination fees and costs | 54,279                | 56,142                |
| Unearned income                              | <u>-</u>              | <u>3,976</u>          |
| Loans, net                                   | <u>\$ 166,217,889</u> | <u>\$ 152,136,327</u> |

Included in the above balance of net loans are nonaccrual loans of \$2,208,400 and \$58,300 at December 31, 2006 and 2005, respectively. If interest on those nonaccrual loans had been accrued, such income would have approximated \$63,341, \$5,662 and \$0 for the years ended December 31, 2006, 2005 and 2004, respectively.

The bank makes loans to its directors, executive officers and their related interests in the normal course of business. During the year 2006, the bank's definition of executive officer was amended to be consistent with regulatory guidance. Therefore, the prior year's information has been restated. The activity with respect to these loans for the years ended December 31, 2006 and 2005 follows:

|                    | <b>2006</b>         | <b>2005</b>         |
|--------------------|---------------------|---------------------|
| Balance, beginning | \$ 5,892,713        | \$ 2,758,611        |
| Additions          | 3,801,609           | 6,436,855           |
| Amounts collected  | <u>(3,582,597)</u>  | <u>(3,302,753)</u>  |
| Balance, ending    | <u>\$ 6,111,725</u> | <u>\$ 5,892,713</u> |

The following represents the maturities and sensitivities of loans to changes in interest rates at December 31, 2006, without regard to scheduled periodic principal repayments on amortizing loans:

|  | <b>Due<br/>Within 1 Yr</b> | <b>Due After 1<br/>But Within<br/>5 Yrs</b> | <b>Due<br/>After 5 Yrs</b> | <b>Total</b>  |
|--|----------------------------|---|----------------------------|---------------|
| Commercial, financial and agricultural | \$ 2,507,390               | \$ 8,766,556                                | \$ 15,695,049              | \$ 26,968,995 |
| Real estate – construction             | 9,667,018                  | 2,266,383                                   | 2,031,099                  | 13,964,500    |
| Real estate – home equity              | 39,932                     | 75,745                                      | 7,869,576                  | 7,985,253     |
| Real estate – residential mortgage     | 1,370,462                  | 2,547,900                                   | 57,483,111                 | 61,401,473    |
| Real estate – commercial mortgage      | 2,826,013                  | 9,066,782                                   | 33,686,184                 | 45,578,979    |
| Installment loans                      | 828,730                    | 8,461,147                                   | 1,344,980                  | 10,634,857    |

|       |                      |                      |                       |                       |
|-------|----------------------|----------------------|-----------------------|-----------------------|
| Other | <u>851,951</u>       | <u>623,189</u>       | <u>136,009</u>        | <u>1,611,149</u>      |
| Total | <u>\$ 18,091,496</u> | <u>\$ 31,807,702</u> | <u>\$ 118,246,008</u> | <u>\$ 168,145,206</u> |

Loans due after one year with:

|                |                       |
|----------------|-----------------------|
| Variable rates | \$ 121,306,194        |
| Fixed rates    | <u>28,747,516</u>     |
| Total          | <u>\$ 150,053,710</u> |

**Concentrations of Credit Risk:** The bank grants installment, commercial and residential loans to customers in central and eastern West Virginia in striving to maintain a diversified loan portfolio. Nonetheless, concentrations of credit, defined as loans to a customer, the customers' related parties, or to a number of customers operating in the same industry, which in the aggregate total 25% or more of capital can occur. At December 31, 2006, we had five such concentrations.

Direct and indirect extensions of credit to automobile dealers, consisting of floor plan loans and other commercial loans which are generally secured by liens on the subject inventories or equipment, totaled \$7,104,923. Extensions of credit to companies operating in the lumber industry and their related parties totaled \$5,325,262. These loans are generally made for the purpose of financing logging equipment and are typically secured by liens on the subject equipment. Extensions of credit to companies in the hotel/motel industry totaled \$8,543,101. These loans are usually made to finance the purchase, operation or improvement of hotels and motels and are generally secured by liens on the subject property. Extensions of credit for out-of-area commercial real estate projects totaled \$7,710,503. The bank participates in these loans through a network of allied banks. Participations in these loans are solely a factor of a detailed review of credit quality. Also, extensions of credit for ski resort related loans totaled \$16,122,842. These loans are extended to business, residential, and rental properties in and around various West Virginia ski resorts. Additional collateral such as pledges of accounts receivable, real estate, or personal guarantees may also be required when granting any of these credits. The bank evaluates each such customer's credit worthiness on a case-by-case basis. The amount of collateral obtained is based upon these credit evaluations.

#### Note 6. Allowance for Loan Losses

An analysis of the allowance for loan losses for the years ended December 31, 2006, 2005 and 2004, is as follows:

|  | <u>2006</u>         | <u>2005</u>         | <u>2004</u>         |
|--|---------------------|---------------------|---------------------|
| Balance, beginning of year             | \$ 1,597,006        | \$ 1,378,106        | \$ 1,395,908        |
| Charge offs:                           |                     |                     |                     |
| Commercial, financial and agricultural | 123,400             | -                   | 1,030,651           |
| Real estate – residential mortgage     | -                   | -                   | 35,597              |
| Installment                            | <u>39,130</u>       | <u>90,212</u>       | <u>98,263</u>       |
| Total                                  | <u>162,530</u>      | <u>90,212</u>       | <u>1,164,511</u>    |
| Recoveries:                            |                     |                     |                     |
| Commercial, financial and agricultural | 4,100               | 5,660               | 191,439             |
| Real estate – residential mortgage     | -                   | 1,022               | 210                 |
| Installment                            | <u>11,077</u>       | <u>27,763</u>       | <u>20,161</u>       |
| Total                                  | <u>15,177</u>       | <u>34,445</u>       | <u>211,810</u>      |
| Net charge-offs                        | 147,353             | 55,767              | 952,701             |
| Provision for loan losses              | <u>423,385</u>      | <u>274,667</u>      | <u>934,899</u>      |
| Balance, end of year                   | <u>\$ 1,873,038</u> | <u>\$ 1,597,006</u> | <u>\$ 1,378,106</u> |

The following summary provides additional information regarding impaired, nonaccrual and past due loans:

|   | <b>December 31,</b> |                     |
|---|---------------------|---------------------|
|   | <b>2006</b>         | <b>2005</b>         |
| Impaired loans without a valuation allowance            | \$ 155,849          | \$ 754,609          |
| Impaired loans with a valuation allowance               | 4,991,814           | 2,895,466           |
| Total impaired loans                                    | <u>\$ 5,147,663</u> | <u>\$ 3,650,075</u> |
| Valuation allowance related to impaired loans           | \$ 990,482          | \$ 537,919          |
| Total nonaccrual loans                                  | 2,208,400           | 58,300              |
| Total loans past due ninety days or more still accruing | -                   | 538,167             |

|   | <b>Year Ended December 31,</b> |              |             |
|---|--------------------------------|--------------|-------------|
|   | <b>2006</b>                    | <b>2005</b>  | <b>2004</b> |
| Average investment in impaired loans                            | \$ 3,846,072                   | \$ 3,974,629 | \$ 49,193   |
| Interest income recognized on impaired loans                    | 331,872                        | 292,013      | 2,536       |
| Interest income recognized on a cash basis<br>on impaired loans | 276,007                        | 278,334      | 2,343       |

No additional funds are committed to be advanced in connection with impaired loans.

### Note 7. Bank Premises and Equipment

The major categories of bank premises and equipment and accumulated depreciation and amortization at December 31, 2006 and 2005, are summarized as follows:

|                                   | <b>2006</b>         | <b>2005</b>         |
|-----------------------------------|---------------------|---------------------|
| Land                              | \$ 950,403          | \$ 956,069          |
| Buildings and improvements        | 4,870,355           | 4,786,825           |
| Furniture and equipment           | <u>2,977,312</u>    | <u>2,636,036</u>    |
| Total bank premises and equipment | 8,798,070           | 8,378,930           |
| Less accumulated depreciation     | <u>4,466,757</u>    | <u>4,186,870</u>    |
| Bank premises and equipment, net  | <u>\$ 4,331,313</u> | <u>\$ 4,192,060</u> |

Depreciation expense for the years ended December 31, 2006, 2005 and 2004, totaled \$338,543, \$400,996 and \$404,329, respectively.

### Note 8. Deposits

The following is a summary of interest bearing deposits by type as of December 31, 2006 and 2005:

|  | <b>2006</b>           | <b>2005</b>           |
|--|-----------------------|-----------------------|
| Interest bearing checking accounts           | \$ 41,767,746         | \$ 44,667,563         |
| Money market accounts                        | 5,979,073             | 7,645,508             |
| Savings accounts                             | 22,745,891            | 24,687,908            |
| Certificates of deposit under \$100,000      | 59,949,884            | 52,578,930            |
| Certificates of deposit of \$100,000 or more | <u>38,997,134</u>     | <u>32,258,028</u>     |
| Total  | <u>\$ 169,439,728</u> | <u>\$ 161,837,937</u> |

Interest expense on deposits is summarized below:

|  | <b>2006</b>         | <b>2005</b>         | <b>2004</b>         |
|--|---------------------|---------------------|---------------------|
| Interest bearing checking accounts           | \$ 1,161,291        | \$ 613,132          | \$ 347,520          |
| Money market accounts                        | 33,159              | 49,703              | 37,609              |
| Savings accounts                             | 120,996             | 129,933             | 126,818             |
| Certificates of deposit under \$100,000      | 2,072,523           | 1,490,864           | 1,262,552           |
| Certificates of deposit of \$100,000 or more | <u>1,493,549</u>    | <u>1,092,905</u>    | <u>871,348</u>      |
| Total  | <u>\$ 4,881,518</u> | <u>\$ 3,376,537</u> | <u>\$ 2,645,847</u> |

The following is a summary of the maturity distribution of certificates of deposit in amounts of \$100,000 or more as of December 31, 2006 and 2005:

|                           | <u>2006</u>          |                | <u>2005</u>          |                |
|---------------------------|----------------------|----------------|----------------------|----------------|
|                           | <u>Amount</u>        | <u>Percent</u> | <u>Amount</u>        | <u>Percent</u> |
| Three months or less      | \$ 2,350,997         | 6.03%          | \$ 4,709,115         | 14.60%         |
| Three through six months  | 4,370,990            | 11.21          | 4,018,345            | 12.46          |
| Six through twelve months | 10,680,396           | 27.39          | 4,839,600            | 15.00          |
| Over twelve months        | <u>21,594,751</u>    | <u>55.37</u>   | <u>18,690,968</u>    | <u>57.94</u>   |
| Total                     | <u>\$ 38,997,134</u> | <u>100.00%</u> | <u>\$ 32,258,028</u> | <u>100.00%</u> |

A summary of the maturities for all time deposits as of December 31, 2006, follows:

| <u>Year</u> | <u>Amount</u>        |
|-------------|----------------------|
| 2007        | \$ 47,982,258        |
| 2008        | 20,037,273           |
| 2009        | 6,317,944            |
| 2010        | 5,490,353            |
| 2011        | 13,648,290           |
| After 2011  | <u>5,470,900</u>     |
| Total       | <u>\$ 98,947,018</u> |

At December 31, 2006 and 2005, deposits of related parties including directors, executive officers, and their related interests of Citizens Financial Corp. and subsidiary approximated \$2,748,807 and 1,636,391, respectively.

#### **Note 9. Derivative Instruments**

From 2001 to 2004, the bank offered a product known as the Index Powered CD to its customers. This is a five year certificate of deposit which, if held to maturity, provides the customer with guaranteed return of principal and interest which is linked to the performance of the Standard and Poor's 500 Index over the term of the certificate of deposit. As of December 31, 2006 and 2005 the notional value of these deposits was \$894,278 and \$904,278, respectively.

The linkage of the interest earned on the certificate of deposit and the return of the index is considered an equity option and is accounted for as an embedded derivative under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). As required by SFAS 133, the fair value of the embedded derivative is deducted from the certificate of deposit creating a discount that is amortized to interest expense using the effective interest method over the term of the certificate of deposit. The corresponding equity option is carried as a liability at fair value with changes in the value recognized in current earnings.

To manage the market risk associated with this product, the bank entered into interest rate swap agreements with the Federal Home Loan Bank of Pittsburgh ("FHLB") for the notional amount of the certificate of deposit. Under these agreements the bank pays either fixed or variable interest to the FHLB quarterly over the term of the certificate of deposit and the FHLB pays the bank the amount of interest due the customer at maturity.

This interest rate swap also represents a derivative contract and is accounted for as a fair value hedge under SFAS 133. As such, it is carried as an asset at fair value with changes in value being recognized in current earnings. The impact of our derivative activities on pretax income was \$(43,501) in 2006, \$(37,865) in 2005 and \$(34,232) in 2004.

#### **Note 10. Income Taxes**

The components of applicable income tax expense/(benefit) for the years ended December 31, 2006, 2005 and 2004, are as follows:

|          | <u>2006</u>    | <u>2005</u>    | <u>2004</u>   |
|----------|----------------|----------------|---------------|
| Current: |                |                |               |
| Federal  | \$ 986,391     | \$ 982,912     | \$ 438,819    |
| State    | <u>144,201</u> | <u>146,870</u> | <u>54,948</u> |

|           |                   |                   |                   |
|-----------|-------------------|-------------------|-------------------|
|           | <u>1,130,592</u>  | <u>1,129,782</u>  | <u>493,767</u>    |
| Deferred: |                   |                   |                   |
| Federal   | (162,754)         | (181,117)         | (59,794)          |
| State     | <u>(12,192)</u>   | <u>(21,307)</u>   | <u>(7,035)</u>    |
|           | <u>(174,946)</u>  | <u>(202,424)</u>  | <u>(66,829)</u>   |
| Total     | <u>\$ 955,646</u> | <u>\$ 927,358</u> | <u>\$ 426,938</u> |

Deferred income taxes reflect the impact of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured for tax purposes. Deferred tax assets and liabilities represent the future tax return consequences of temporary differences, which will either be taxable or deductible when the related assets and liabilities are recovered or settled.

The tax effects of temporary differences which give rise to the company's deferred tax assets and liabilities as of December 31, 2006 and 2005, are as follows:

|                                     | <u>2006</u>         | <u>2005</u>         |
|-------------------------------------|---------------------|---------------------|
| Deferred tax assets:                |                     |                     |
| Allowance for loan losses           | \$ 562,127          | \$ 457,236          |
| Accrued income and expenses         | 18,553              | 13,028              |
| Employee benefit plans              | 832,401             | 665,250             |
| Net loan origination fees and costs | 20,624              | 21,335              |
| Net unrealized loss on securities   | <u>232,041</u>      | <u>367,316</u>      |
|                                     | <u>1,665,746</u>    | <u>1,524,165</u>    |
| Deferred tax liabilities:           |                     |                     |
| Accretion on securities             | (26,265)            | (26,132)            |
| Depreciation                        | <u>(197,141)</u>    | <u>(146,556)</u>    |
|                                     | <u>(223,406)</u>    | <u>(172,688)</u>    |
| Net deferred tax asset              | <u>\$ 1,442,340</u> | <u>\$ 1,351,477</u> |

A reconciliation between the amount of reported income tax expense and the amount computed by multiplying the statutory income tax rate by book pretax income for the years ended December 31, 2006, 2005 and 2004, is as follows:

|  | <u>2006</u>       |                | <u>2005</u>       |                | <u>2004</u>       |                |
|--|-------------------|----------------|-------------------|----------------|-------------------|----------------|
|  | <u>Amount</u>     | <u>Percent</u> | <u>Amount</u>     | <u>Percent</u> | <u>Amount</u>     | <u>Percent</u> |
| Computed tax at applicable statutory rate      | \$1,034,463       | 34.0%          | \$ 1,011,345      | 34.0%          | \$ 708,314        | 34.0%          |
| Increase/(decrease) in taxes resulting from:   |                   |                |                   |                |                   |                |
| Tax-exempt interest                            | (149,248)         | (4.9)          | (147,527)         | (5.0)          | (151,826)         | (7.3)          |
| State income taxes, net of federal tax benefit | 87,126            | 2.8            | 82,872            | 2.8            | 30,963            | 1.5            |
| Tax exempt income on retirement plans          | (27,772)          | (0.9)          | (27,755)          | (0.9)          | (41,435)          | (2.0)          |
| Other  | <u>11,077</u>     | <u>0.4</u>     | <u>8,423</u>      | <u>0.3</u>     | <u>(119,078)</u>  | <u>(5.7)</u>   |
| Applicable income taxes                        | <u>\$ 955,646</u> | <u>31.4%</u>   | <u>\$ 927,358</u> | <u>31.2%</u>   | <u>\$ 426,938</u> | <u>20.5%</u>   |

#### Note 11. Employee Benefit Plans

The bank offers a number of benefit plans to its employees and directors. Among them are pension and other postretirement benefit plans which are described below.

**Pension Plan:** The bank has a defined benefit pension plan covering all employees who meet the eligibility requirements. To be eligible, an employee must be 21 years of age and have completed one year/1,000 hours of continuous service. The plan provides benefits based on the participant's years of service and five year average final compensation. Our funding policy is to make annual contributions as permitted or required by applicable regulations.

**401(k) Plan:** A 401(k) profit sharing plan is provided for the benefit of all employees who have attained the age of 21 and completed one year/1,000 hours of continuous service. The plan allows participating employees to contribute amounts up to the limits set by the Internal Revenue Service and permits the bank to make discretionary contributions to the plan in such amount as the Board may determine to be appropriate. Contributions made to the plan by the bank for the years ended December 31, 2006, 2005 and 2004, were \$81,000, \$77,000 and \$63,000, respectively.

**Executive Supplemental Income Plan:** Subsequent to an amendment to the bank's pension benefit formula in 1995, it offered a nonqualified executive supplemental income plan to certain senior officers, some of whom are now retired, as a means of overcoming the reduced pension benefit. The plan provides predetermined fixed monthly income for a period of 180 months to the participants upon retirement. It is funded by life insurance contracts which the bank purchased. The bank has been named the beneficiary of those contracts. The liability accrued under this plan at December 31, 2006 and 2005 was \$253,292 and \$258,726, respectively. The cash surrender values of the underlying insurance contracts at those same dates were \$516,130 and \$469,540. Expenses associated with the plan were \$8,549 in 2006, \$11,217 in 2005, and \$13,806 in 2004.

**Executive and Director Supplemental Retirement Plan:** Effective January 1, 2003, the bank entered into a non-qualified supplemental executive and director retirement plan with various officers and directors of the bank which provides them with income benefits payable at retirement age or death. In connection with this plan, the bank purchased life insurance contracts in 2002 for \$2,000,000. These contracts are not assets of the plan but are instead owned by the bank and had cash surrender values of \$2,189,860 at December 31, 2006 and \$2,108,177 at December 31, 2005. Liabilities under the plan were \$653,097 at December 31, 2006 and \$526,972 at December 31, 2005. Expenses of the plan, net of income for the increase in the cash surrender value, were \$66,936 in 2006, \$51,992 in 2005 and \$99,118 in 2004.

**Postretirement Healthcare and Life Insurance Plan:** The bank sponsors a postretirement healthcare plan and a postretirement life insurance plan for all retired employees that meet certain eligibility requirements. Both plans are contributory with retiree contributions that are adjustable based on various factors, some of which are discretionary. These factors are intended to hold constant the maximum monthly benefit of \$100 payable per eligible retiree for postretirement health care. Accordingly, an assumed 1 percentage point increase or decrease in healthcare cost trend rates would not impact the healthcare plan's accumulated postretirement benefit obligation or the aggregate of the plans service and interest costs. Both the healthcare plan and life insurance plan are unfunded.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)" (SFAS 158). More information regarding SFAS 158 can be reviewed under Significant New Accounting Pronouncements in Note 1 of these consolidated financial statements. SFAS 158 requires adoption on a prospective basis beginning for the year ended December 31, 2006. The following table reflects the incremental effect of applying SFAS 158 on individual line items as presented in the consolidated balance sheets as of December 31, 2006.

|   | <b>Before<br/>Application<br/>of SFAS 158</b> | <b>Adjustments<br/>for Pension<br/>Benefits</b> | <b>Adjustments<br/>for Other<br/>Benefits</b> | <b>After<br/>Application<br/>of SFAS</b> |
|---|---|---|---|--|
| <b>158</b>                                    |   |   |   |  |
| Other assets                                  | \$ 5,060,073                                  | \$ 132,467                                      | \$ (47,739)                                   | \$ 5,144,801                             |
| Total assets                                  | 242,981,749                                   | 132,467   | (47,739)                                      | 243,066,477                              |
| Other liabilities                             | 2,591,070                                     | 348,594   | (125,630)                                     | 2,814,034                                |
| Total liabilities                             | 222,479,489                                   | 348,594   | (125,630)                                     | 222,702,453                              |
| Accumulated other comprehensive income/(loss) | (1,095,163)                                   | (216,127)                                       | 77,891  | (1,233,399)                              |
| Total shareholders' equity                    | 20,502,260                                    | (216,127)                                       | 77,891  | 20,364,024                               |

Additional information regarding the company's pension and other postretirement benefits is presented below in accordance with SFAS 158 for 2006. Previous year information for 2005 and 2004 is presented in accordance with the previous FASB Statements. The measurement date used for the pension disclosures is October 31 for all years presented.

|  | <u>Pension Benefits</u> |                     | <u>Other Benefits</u> |                     |
|--|-------------------------|---------------------|-----------------------|---------------------|
|  | <u>2006</u>             | <u>2005</u>         | <u>2006</u>           | <u>2005</u>         |
| Change in benefit obligation   |                         |                     |                       |                     |
| Benefit obligation at beginning of year                                  | \$ 4,734,599            | \$ 4,085,958        | \$ 613,217            | \$ 571,082          |
| Service cost   | 112,312                 | 98,730              | 24,242                | 23,575              |
| Interest cost  | 271,181                 | 267,484             | 31,769                | 31,084              |
| Actuarial (gain)/loss  | (68,016)                | 475,590             | (119,255)             | 2,640               |
| Benefits paid  | <u>(238,649)</u>        | <u>(193,163)</u>    | <u>(27,039)</u>       | <u>(15,164)</u>     |
| Benefit obligation at end of year  | <u>\$ 4,811,427</u>     | <u>\$ 4,734,599</u> | <u>\$ 522,934</u>     | <u>\$ 613,217</u>   |
| Change in plan assets  |                         |                     |                       |                     |
| Fair value of plan assets at beginning of year                           | \$ 3,755,700            | \$ 3,622,722        | \$ -                  | \$ -                |
| Actual return on plan assets   | 471,946                 | 326,141             | -                     | -                   |
| Employer contribution  | 70,172                  | -                   | 27,039                | 15,164              |
| Benefits paid  | <u>(238,649)</u>        | <u>(193,163)</u>    | <u>(27,039)</u>       | <u>(15,164)</u>     |
| Fair value of plan assets at end of year                                 | <u>\$ 4,059,169</u>     | <u>\$ 3,755,700</u> | <u>\$ -</u>           | <u>\$ -</u>         |
| Funded status  | \$ (752,258)            | \$ (978,899)        | \$ (522,934)          | \$ (613,217)        |
| Unrecognized net actuarial (gain)/loss                                   | N/A                     | 1,840,198           | N/A                   | (136,666)           |
| Unrecognized prior service cost  | N/A                     | (46,491)            | N/A                   | -                   |
| Unrecognized net obligation at transition                                | <u>N/A</u>              | <u>-</u>            | <u>N/A</u>            | <u>146,609</u>      |
| Net amount recognized on consolidated balance sheets                     | <u>\$ (752,258)</u>     | <u>\$ 814,808</u>   | <u>\$ (522,934)</u>   | <u>\$ (603,274)</u> |
| Amounts recognized on consolidated balance sheets as:                    |                         |                     |                       |                     |
| Prepaid benefit cost   | \$ -                    | \$ 814,808          | \$ -                  | \$ -                |
| Accrued benefit liability  | <u>(752,258)</u>        | <u>-</u>            | <u>(522,934)</u>      | <u>(603,274)</u>    |
| Net amount recognized  | <u>\$ (752,258)</u>     | <u>\$ 814,808</u>   | <u>\$ (522,934)</u>   | <u>\$ (603,274)</u> |
| Amounts recognized in accumulated other comprehensive income consist of: |                         |                     |                       |                     |
| Net loss (gain)  | \$ 1,533,873            | \$ N/A              | \$ (251,293)          | \$ N/A              |
| Prior service cost (credit)  | (29,523)                | N/A                 | -                     | N/A                 |
| Net obligation at transition   | <u>-</u>                | <u>N/A</u>          | <u>125,663</u>        | <u>N/A</u>          |
|  | <u>\$ 1,504,350</u>     | <u>\$ N/A</u>       | <u>\$ (125,630)</u>   | <u>\$ N/A</u>       |

In 2005 the company recorded a minimum pension liability of \$716,569 net of the related deferred tax asset of \$439,187 in accordance with Statement of Financial Accounting Standard No. 87 (SFAS 87), Employers' Accounting for Pensions. The additional pension liability required under SFAS 87 in 2005 was \$1,155,756.

The accumulated benefit obligation of our pension plan was \$4,213,134 at October 31, 2006 and \$4,096,648 at October 31, 2005.

|   | <u>Pension Benefits</u> |                  |                   | <u>Other Benefits</u> |                  |                  |
|---|-------------------------|------------------|-------------------|-----------------------|------------------|------------------|
|   | <u>2006</u>             | <u>2005</u>      | <u>2004</u>       | <u>2006</u>           | <u>2005</u>      | <u>2004</u>      |
| <b>Components of net periodic benefit cost</b>  |                         |                  |                   |                       |                  |                  |
| Service cost  | \$ 112,312              | \$ 98,730        | \$ 98,265         | \$ 24,242             | \$ 23,575        | \$ 28,104        |
| Interest cost   | 271,181                 | 267,484          | 250,813           | 31,769                | 31,084           | 33,021           |
| Expected return on plan assets  | (329,317)               | (341,241)        | (353,823)         | -                     | -                | -                |
| Net amortization and deferral   | (16,968)                | (16,968)         | (1,016)           | 16,318                | 15,664           | 17,130           |
| Recognized net actuarial loss   | <u>95,680</u>           | <u>47,051</u>    | <u>-</u>          | <u>-</u>              | <u>-</u>         | <u>-</u>         |
| Net periodic benefit cost   | <u>132,888</u>          | <u>55,056</u>    | <u>(5,761)</u>    | <u>72,329</u>         | <u>70,323</u>    | <u>78,255</u>    |
| <b>Other changes in plan assets and benefit obligations recognized in other comprehensive income:</b> |                         |                  |                   |                       |                  |                  |
| Net (gain)/loss for period  | (210,645)               | N/A              | N/A               | -                     | N/A              | N/A              |
| Amortization of prior service cost  | 16,968                  | N/A              | N/A               | -                     | N/A              | N/A              |
| Amortization of net loss/(gain)   | <u>(95,680)</u>         | <u>N/A</u>       | <u>N/A</u>        | <u>-</u>              | <u>N/A</u>       | <u>N/A</u>       |
| Total recognized in other comprehensive income  | <u>(289,357)</u>        | <u>N/A</u>       | <u>N/A</u>        | <u>-</u>              | <u>N/A</u>       | <u>N/A</u>       |
| Total recognized in net periodic benefit cost and other comprehensive income                          | <u>\$ (156,469)</u>     | <u>\$ 55,056</u> | <u>\$ (5,761)</u> | <u>\$ 72,329</u>      | <u>\$ 70,323</u> | <u>\$ 78,255</u> |

Unrecognized prior service cost is expensed using a straight-line amortization of the cost over the average future service of employees expected to receive benefits under the plan.

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$87,670 and \$(16,968), respectively. The estimated transition obligation for the other defined benefit postretirement plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is \$20,946.

**Weighted-average assumptions used to determine net periodic benefit cost**

|  | <u>Pension Benefits</u> |             |             | <u>Other Benefits</u> |             |             |
|--|-------------------------|-------------|-------------|-----------------------|-------------|-------------|
|  | <u>2006</u>             | <u>2005</u> | <u>2004</u> | <u>2006</u>           | <u>2005</u> | <u>2004</u> |
| Discount rate                            | 5.75%                   | 6.50%       | 6.50%       | 5.75%                 | 5.75%       | 6.25%       |
| Expected long-term return on plan assets | 8.50%                   | 8.50%       | 8.50%       | N/A                   | N/A         | N/A         |

|                               |       |       |       |     |     |     |
|-------------------------------|-------|-------|-------|-----|-----|-----|
| Rate of compensation increase | 3.00% | 3.50% | 3.50% | N/A | N/A | N/A |
|-------------------------------|-------|-------|-------|-----|-----|-----|

**Weighted-average assumptions used to determine benefit obligations**

|                               | <u>Pension Benefits</u> |             |  | <u>Other Benefits</u> |             |
|-------------------------------|-------------------------|-------------|--|-----------------------|-------------|
|                               | <u>2006</u>             | <u>2005</u> |  | <u>2006</u>           | <u>2005</u> |
| Discount rate                 | 6.00%                   | 5.75%       |  | 5.75%                 | 5.75%       |
| Rate of compensation increase | 3.00%                   | 3.00%       |  | N/A                   | N/A         |

The expected long-term rate of return for the pension plan is based on the expected return of each of the plans' asset categories (detailed below), weighted based on the median of the target allocation of each category.

|                    | Target<br>Allocation<br>2007 | Allowable<br>Range | Percentage of Plan<br>Assets at October 31 |             |
|--------------------|------------------------------|--------------------|--|-------------|
|                    |                              |                    | 2006                                       | 2005        |
| <b>Plan Assets</b> |                              |                    |  |             |
| Equity securities  | 75%                          | 40-80%             | 74%  | 73%         |
| Debt securities    | 25%                          | 20-40%             | 20%  | 22%         |
| Real estate        | 0%                           | 0%                 | 0%   | 0%          |
| Other              | 0%                           | 3-10%              | 6%   | 5%          |
| Total              | <u>100%</u>                  |                    | <u>100%</u>                                | <u>100%</u> |

### Investment Policy and Strategy

The policy, as established by the Pension Committee, is to invest assets per the target allocations stated above. The assets will be reallocated periodically to meet the above target allocations. The investment policy will be reviewed periodically, under the advisement of a certified investment advisor, to determine if the policy should be changed.

The overall investment return goal is to achieve a return greater than a blended mix of stated indices tailored to the same asset mix of the plan assets by 0.5% after fees over a rolling 5-year moving average basis.

Allowable assets include cash equivalents, fixed income securities, equity securities, exchange traded index funds and GICs. Prohibited investments include, but are not limited to, commodities and future contracts, private placements, options, limited partnerships, venture capital investments, real estate and IO, PO, and residual tranche CMOs. Unless a specific derivative security is allowed per the plan document permission must be sought from the Pension Committee to include such investments.

In order to achieve a prudent level of portfolio diversification, the securities of any one company should not exceed more than 10% of the total plan assets, and no more than the 25% of total plan assets should be invested in any one industry (other than securities of U.S. Government or Agencies). Additionally, no more than 20% of the plan assets shall be invested in foreign securities (both equity and fixed).

### Cash Flows

**Contributions:** We expect to contribute approximately \$127,774 to our pension plan in 2007. No contributions are expected to be made to our other postretirement plans, however.

**Estimated Future Benefits Payments:** The following benefit payments, which reflect future service, are expected to be paid:

|           | <u>Pension Benefits</u> | <u>Other Benefits</u> |
|-----------|-------------------------|-----------------------|
| 2007      | \$ 238,675              | \$ 32,554             |
| 2008      | 265,176                 | 30,917                |
| 2009      | 277,411                 | 31,826                |
| 2010      | 290,119                 | 32,809                |
| 2011      | 295,524                 | 36,629                |
| 2012-2016 | 1,570,028               | 191,733               |

### Note 12. Other Borrowings

**Short-Term Borrowings:** During 2006 and 2005, our short-term borrowings consisted of securities sold under agreements to repurchase (repurchase agreements), advances under a line of credit with the Federal Home Loan Bank of Pittsburgh (FHLB) and federal funds purchased. Interest is paid on the repurchase agreements based on either fixed or variable rates as determined upon origination. At December 31, 2006 and 2005, securities with an amortized cost of \$14,095,926 and \$17,097,069, respectively, and estimated fair values of \$13,900,030 and \$16,767,119, respectively, were pledged to secure the repurchase agreements.

As a member of the FHLB, the bank has access to various lines of credit under programs administered by the FHLB. Borrowings under these arrangements bear interest at the interest rate posted by the FHLB on the day of the borrowing and are subject to change daily. The lines of credit are secured by a blanket lien on all unpledged and unencumbered assets.

The following information is provided relative to our short-term borrowing obligations:

|   | <u>2006</u>                 |                       |                                | <u>2005</u>                 |                       |                                |
|---|-----------------------------|-----------------------|--------------------------------|-----------------------------|-----------------------|--------------------------------|
|   | <u>Repurchase Agreement</u> | <u>Line of Credit</u> | <u>Federal Funds Purchased</u> | <u>Repurchase Agreement</u> | <u>Line of Credit</u> | <u>Federal Funds Purchased</u> |
| Amount outstanding at December 31             | \$ 15,970,434               | \$ 3,438,000          | \$ 425,000                     | \$ 20,511,399               | \$ -                  | \$ -                           |
| Weighted average interest rate at December 31 | 3.99%                       | 5.40%                 | 5.56%                          | 2.50%                       | -                     | -                              |
| Maximum month-end amount outstanding          | \$ 25,052,293               | \$ 9,630,000          | \$ 2,800,000                   | \$ 24,983,307               | \$ 1,389,500          | \$ -                           |
| Average daily amount outstanding              | \$ 19,204,359               | \$ 2,699,222          | \$ 69,521                      | \$ 21,635,619               | \$ 108,678            | \$ 14,178                      |
| Weighted average interest rate for the year   | 3.43%                       | 5.20%                 | 4.79%                          | 2.30%                       | 3.60%                 | 3.55%                          |

**Long-Term Borrowings:** Long-term borrowings of \$3,511,770 and \$5,145,328 at December 31, 2006 and 2005, respectively, consist of advances from the FHLB which are used to finance specific lending activities. These advances carry fixed interest rates ranging from 1.00% to 5.00% while the weighted average interest rate at December 31, 2006 was 4.25%. The weighted average interest rate for the year ending December 31, 2006 was 4.09%.

A summary of the maturities of the long-term borrowings for the next five years is as follows:

| <u>Year</u>         | <u>Amount</u>       |
|---------------------|---------------------|
| 2007                | \$ 792,905          |
| 2008                | 375,518             |
| 2009                | 392,916             |
| 2010                | 411,119             |
| 2011                | 430,167             |
| 2012 and thereafter | 1,109,145           |
| Total               | <u>\$ 3,511,770</u> |

### Note 13. Commitments and Contingencies

At December 31, 2006 and 2005, the bank maintained required reserve balances with the Federal Reserve Bank of Richmond approximating \$123,000 and \$1,384,000, respectively. The bank does not earn interest on such reserve balances.

**Litigation:** We are involved in various legal actions arising in the ordinary course of business. In the opinion of counsel, the outcome of these matters will not have a significant adverse effect on our financial condition or results of operations.

**Financial Instruments With Off-Balance-Sheet Risk:** The bank 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. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the bank has in particular classes of financial instruments.

Financial instruments whose contract amounts represent credit risk

Contract Amount  
2006      2005

|                              |                      |                      |
|------------------------------|----------------------|----------------------|
| Commitments to extend credit | \$ 22,054,312        | \$ 26,919,444        |
| Standby letters of credit    | <u>461,689</u>       | <u>559,244</u>       |
| Total                        | <u>\$ 22,516,001</u> | <u>\$ 27,478,688</u> |

The bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, equipment or real estate.

Standby letters of credit are conditional commitments issued by the bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans. These letters of credit are generally uncollateralized.

**Note 14. Shareholders' Equity and Restrictions on Dividends**

The primary source of funds for the dividends paid by Citizens Financial Corp. is dividends received from Citizens National Bank. Dividends paid by the bank are subject to restrictions by banking regulations. The most restrictive provision requires approval by the Office of the Comptroller of the Currency if dividends declared in any year exceed the year's net income, as defined, plus the retained net profits of the two preceding years. At December 31, 2006, the net retained profits available for distribution to Citizens Financial Corp. as dividends without regulatory approval approximate \$1,707,414 or 8.4% of consolidated net assets.

The company and bank are subject to various regulatory capital requirements administered by the federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the company and bank must meet specific capital guidelines that involve quantitative measures of the company's and bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The company and bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the company and bank to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. We believe, as of December 31, 2006, that the company and bank meet all capital adequacy requirements to which they are subject.

The most recent notification from the Office of the Comptroller of the Currency categorized the bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table below. There are no conditions or events since that notification that we believe have changed the bank's category.

The bank's actual capital amounts and ratios, which are the same as those for the holding company on a consolidated basis, are presented in the following table (in thousands).

|  | Actual   |        | For Capital Adequacy Purposes |       | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|--|----------|--------|-------------------------------|-------|--|--------|
|  | Amount   | Ratio  | Amount                        | Ratio | Amount   | Ratio  |
| <b>As of December 31, 2006:</b>          |          |        |                               |       |  |        |
| Total Capital (to Risk Weighted Assets)  | \$22,413 | 12.95% | \$13,846                      | 8.00% | \$17,307   | 10.00% |
| Tier I Capital (to Risk Weighted Assets) | 20,540   | 11.87  | 6,922                         | 4.00  | 10,382   | 6.00   |
| Tier I Capital (to Average Assets)       | 20,540   | 8.49   | 9,677                         | 4.00  | 12,097   | 5.00   |
| <b>As of December 31, 2005:</b>          |          |        |                               |       |  |        |
| Total Capital (to Risk Weighted Assets)  | \$21,681 | 13.30% | \$13,041                      | 8.00% | \$16,302   | 10.00% |
| Tier I Capital (to Risk Weighted Assets) | 20,084   | 12.32  | 6,521                         | 4.00  | 9,781  | 6.00   |
| Tier I Capital (to Average Assets)       | 20,084   | 8.46   | 9,496                         | 4.00  | 11,870   | 5.00   |

#### Note 15. Fair Value of Financial Instruments and Interest Rate Risk

The following summarizes the methods and significant assumptions used in estimating fair value disclosures for financial instruments.

**Cash and Due From Banks:** The carrying values of cash and due from banks approximate their estimated fair values.

**Federal Funds Sold:** The carrying values of federal funds sold approximate their estimated fair values.

**Securities:** Estimated fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

**Loans:** The estimated fair values for loans are computed based on scheduled future cash flows of principal and interest, discounted at interest rates currently offered for loans with similar terms to borrowers of similar credit quality. No prepayments of principal are assumed.

**Accrued Interest Receivable and Payable:** The carrying values of accrued interest receivable and payable approximate their estimated fair values.

**Deposits:** The estimated fair values of demand deposits (i.e. noninterest bearing and interest bearing checking), money market, savings and other variable rate deposits approximate their carrying values. Fair values of fixed maturity deposits are estimated using a discounted cash flow methodology at rates currently offered for deposits with similar remaining maturities. Any intangible value of long-term relationships with depositors is not considered in estimating the fair values disclosed.

**Short-Term Borrowings:** The carrying values of short-term borrowings approximate their estimated fair values.

**Long-Term Borrowings:** The fair values of long-term borrowings are estimated by discounting scheduled future payments of principal and interest at current rates available on borrowings with similar terms.

**Off-Balance-Sheet Instruments:** The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit standing of the counterparties. The amounts of fees currently charged on commitments and standby letters of credit are deemed insignificant, and therefore, the estimated fair values and carrying values are not shown below.

**Derivative Financial Instruments:** The fair values of the interest rate swaps are based on quoted market prices of like products.

The carrying values and estimated fair values of the company's financial instruments are summarized below:

|  | <u>December 31, 2006</u> |                             | <u>December 31, 2005</u> |                             |
|--|--------------------------|-----------------------------|--------------------------|-----------------------------|
|  | <u>Carrying Value</u>    | <u>Estimated Fair Value</u> | <u>Carrying Value</u>    | <u>Estimated Fair Value</u> |
| <b>Financial assets:</b>                   |                          |                             |                          |                             |
| Cash and due from banks                    | \$ 6,064,890             | \$ 6,064,890                | \$ 6,770,128             | \$ 6,770,128                |
| Interest bearing deposits with other banks | 29,858                   | 28,858                      | 102,608                  | 102,608                     |
| Federal funds sold                         | -                        | -                           | 1,900,000                | 1,900,000                   |
| Securities available for sale              | 59,745,539               | 59,745,539                  | 66,854,339               | 66,854,339                  |
| Loans, net                                 | 166,217,889              | 158,001,485                 | 152,136,327              | 142,877,836                 |
| Accrued interest receivable                | 1,393,468                | 1,393,468                   | 1,321,120                | 1,321,120                   |
| <b>Financial liabilities:</b>              |                          |                             |                          |                             |
| Deposits                                   | \$ 196,543,215           | \$ 197,344,439              | \$ 190,485,729           | \$ 190,482,623              |
| Short-term borrowings                      | 19,833,434               | 19,833,434                  | 20,511,399               | 20,511,399                  |
| Long-term borrowings                       | 3,511,770                | 3,426,840                   | 5,145,328                | 5,043,043                   |
| Accrued interest payable                   | 511,094                  | 511,094                     | 333,198                  | 333,198                     |
| <b>Financial instruments:</b>              |                          |                             |                          |                             |
| Interest rate swaps and call options       | \$ 21,054                | \$ 21,054                   | \$ 53,271                | \$ 53,271                   |

The company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the company's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to the company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the company's overall interest rate risk.

#### Note 16. Condensed Financial Statements of Parent Company

Information relative to the parent company's balance sheets at December 31, 2006 and 2005, and the related statements of income and cash flows for the years ended December 31, 2006, 2005 and 2004, are presented below.

|  | <u>December 31,</u>  |                      |
|--|----------------------|----------------------|
|  | <u>2006</u>          | <u>2005</u>          |
| <b>Balance Sheets</b>  |                      |                      |
| <b>Assets</b>  |                      |                      |
| Cash   | \$ 2,853             | \$ 2,136             |
| Investment in subsidiary   | 20,275,166           | 19,611,169           |
| <b>Total assets</b>  | <b>\$ 20,278,019</b> | <b>\$ 19,613,305</b> |
| <b>Shareholders' equity</b>  |                      |                      |
| Common stock, \$2.00 par value, 4,500,000 and 2,250,000 shares authorized, issued 2,250,000 and 750,000 shares, respectively | \$ 4,500,000         | \$ 1,500,000         |
| Additional paid-in capital   | -                    | 2,100,000            |
| Retained earnings  | 20,842,981           | 20,704,572           |
| Accumulated other comprehensive income/(loss)  | (1,233,399)          | (1,315,875)          |
| Treasury stock at cost, 420,496 and 132,012 shares, respectively   | (3,831,563)          | (3,375,392)          |
| <b>Total shareholders' equity</b>  | <b>\$ 20,278,019</b> | <b>\$ 19,613,305</b> |

|  | <b>For the Years Ended December 31,</b> |                     |                     |
|--|---|---------------------|---------------------|
|  | <b>2006</b>                             | <b>2005</b>         | <b>2004</b>         |
| <b>Statements of Income</b>  |   |                     |                     |
| Income - dividends from subsidiary bank  | \$ 1,512,770                            | \$ 1,288,485        | \$ 1,298,650        |
| Expenses - operating   | <u>7,400</u>                            | <u>6,203</u>        | <u>3,300</u>        |
| Income before equity in undistributed<br>income of subsidiary                        | 1,505,370                               | 1,282,282           | 1,295,350           |
| Equity in undistributed income of subsidiary   | <u>581,521</u>                          | <u>764,904</u>      | <u>360,989</u>      |
| <b>Net income</b>  | <u>\$ 2,086,891</u>                     | <u>\$ 2,047,186</u> | <u>\$ 1,656,339</u> |
|  |   |                     |                     |
|  | <b>For the Years Ended December 31,</b> |                     |                     |
|  | <b>2006</b>                             | <b>2005</b>         | <b>2004</b>         |
| <b>Statements of Cash Flows</b>  |   |                     |                     |
| <b>Cash Flows from Operating Activities</b>  |   |                     |                     |
| Net income   | \$ 2,086,891                            | \$ 2,047,186        | \$ 1,656,339        |
| Adjustments to reconcile net income to net<br>cash provided by operating activities: |   |                     |                     |
| Equity in undistributed income of subsidiary   | <u>(581,521)</u>                        | <u>(764,904)</u>    | <u>(360,989)</u>    |
| <b>Cash provided by operating activities</b>   | <u>1,505,370</u>                        | <u>1,282,282</u>    | <u>1,295,350</u>    |
| <b>Cash Flows from Investing Activities</b>  | <u>-</u>                                | <u>-</u>            | <u>-</u>            |
| <b>Cash Flows from Financing Activities</b>  |   |                     |                     |
| Dividends paid to shareholders   | (1,048,482)                             | (992,726)           | (972,089)           |
| Acquisition of treasury stock  | <u>(456,171)</u>                        | <u>(290,074)</u>    | <u>(322,854)</u>    |
| <b>Cash used in financing activities</b>   | <u>(1,504,653)</u>                      | <u>(1,282,800)</u>  | <u>(1,294,943)</u>  |
| Increase/(decrease) in cash  | 717                                     | (518)               | 407                 |
| <b>Cash:</b>   |   |                     |                     |
| Beginning  | 2,136                                   | 2,654               | 2,247               |
| Ending   | <u>\$ 2,853</u>                         | <u>\$ 2,136</u>     | <u>\$ 2,654</u>     |

## Report of Independent Registered Public Accounting Firm

To the Board of Directors  
Citizens Financial Corp. and Subsidiary  
Elkins, West Virginia

We have audited the consolidated balance sheets of Citizens Financial Corp. and subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citizens Financial Corp. and subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As described in Note 11 to the consolidated financial statements, on December 31, 2006, Citizens Financial Corp. changed its method of accounting for its pension plan to adopt FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

Yount, Hyde & Barbour

Winchester, Virginia  
March 9, 2007

No reportable items.

#### Item 9A. Controls and Procedures

As of the end of the period covered by this Annual Report on Form 10-K, the company, under the supervision and with the participation of management, including the chief executive officer and principal financial officer, carried out an evaluation of the effectiveness of the design and operation of the company's disclosure controls and procedures pursuant to Exchange Act Rules 13a-14 and 15d-4. Based upon that evaluation, the chief executive officer and principal financial officer concluded that the company's disclosure controls and procedures are effective in timely alerting them to material information relating to the company which is required to be included in the company's periodic SEC filings. Subsequent to the date of that evaluation, there have been no significant changes in the company's internal controls or in other factors that could significantly offset internal controls, nor were any corrective actions required with regard to significant deficiencies or material weaknesses.

#### Item 9B. Other Information

No reportable items.

### PART III

#### Item 10. Directors, Executive Officers, and Corporate Governance

The number of directors of the company may consist of not less than five nor more than 25 persons in accordance with the company's Articles of Incorporation. The number of directors is fixed by resolution of a majority vote of shareholders and currently stands at ten. Among them, Mr. John A. Yeager, CPA, serves as an independent director and as the company's audit committee financial expert. Mr. Yeager received his bachelor's degree in accounting from West Virginia University in 1980 and has six years experience in public accounting. During that time Mr. Yeager gained experience in the audit of banks whose characteristics and complexity are similar to Citizens. Mr. Yeager also has served as controller for two nonbanking companies for approximately nineteen years. He has served on the board of directors of Citizens National Bank since April, 1999 and of Citizens Financial Corp. since April, 2003. His current term on the holding company board expires in April, 2009. The following table sets forth the names of all of the persons who have served as directors of Citizens Financial Corp. for the year ended December 31, 2006, their ages and principal occupations, their length of service to the company and the expiration of their present terms.

| <u>Name and Age</u>      | <u>Principal Occupation During Past Five Years</u>  | <u>Director Since (1)</u> | <u>Present Term Expires</u> |
|--------------------------|---|---------------------------|-----------------------------|
| Robert N. Alday<br>91    | President,<br>Phil Williams<br>Coal Company   | September, 1986           | April, 2009                 |
| Max L. Armentrout<br>69  | President, and<br>Chairman of the Board<br>Laurel Lands Corp.;<br>Chairman of the<br>Board, Citizens<br>Financial Corp. | September, 1986           | April, 2008                 |
| William J. Brown<br>60   | President, Hess<br>Oil Co., Inc.  | February, 2000            | April, 2007 (2)             |
| Edward L. Campbell<br>67 | Co-Owner,<br>Retired, Campbell's<br>Market  | February, 2000            | April, 2007 (2)             |

Principal

| <u>Name and Age</u>           | <u>Occupation During Past Five Years</u>  | <u>Director Since (1)</u> | <u>Present Term Expires</u> |
|-------------------------------|---|---------------------------|-----------------------------|
| John F. Harris<br>79          | Retired,<br>Transportation Industry; Senior Vice President,<br>Citizens National Bank         | September, 1986           | April, 2008                 |
| William T. Johnson, Jr.<br>63 | President and Chief Executive Officer and Executive Vice President,<br>Citizens National Bank | April, 2005               | April, 2008                 |
| Cyrus K. Kump<br>60           | President,<br>Kump Enterprises;<br>Kerr Real Estate   | June, 1992                | April, 2009                 |
| Robert J. Schoonover<br>67    | President and Chief Executive Officer, Citizens Financial Corp. and Citizens National Bank    | April, 1998               | April, 2007 (2)             |
| L. T. Williams<br>76          | Consultant,<br>Retired, Elkins Builders Supply  | September, 1986           | April, 2008                 |
| John A. Yeager, CPA<br>48     | Controller,<br>Newlons International Sales, LLC   | April, 2003               | April, 2009                 |

(1) All of the above named directors, with the exception of Mr. Alday, have also served as directors of Citizens National Bank for the past five years on a continuous basis. Mr. Alday has not served Citizens National Bank in any official capacity.

(2) Messrs. Brown, Campbell, and Schoonover have been nominated to stand for reelection to an additional 3 year term expiring in April, 2010.

Set forth below are the executive officers of Citizens Financial Corp. and subsidiary, their age, present position and relations that have existed with affiliates and others during the past five years.

| <u>Name and Age</u>           | <u>Present Position</u>   | <u>Principal Occupation and Banking Experience During the Last Five Years</u>                          |
|-------------------------------|---|--|
| Robert J. Schoonover<br>67    | President & CEO,<br>Citizens Financial Corp.  | President and Chief Executive Officer, Citizens Financial Corp. and Citizens National Bank             |
| William T. Johnson, Jr.<br>63 | Vice President,<br>Citizens Financial Corp.<br>President & CEO,<br>Citizens National Bank | President and Chief Executive Officer and Executive Vice President,<br>Citizens National Bank          |
| Thomas K. Derbyshire<br>48    | Vice President<br>Treasurer   | Executive Vice President,<br>Senior Vice President and Chief Financial Officer, Citizens National Bank |
| Rudy F. Torjak, Jr.           | Chief Credit Officer,   | Chief Credit Officer,  |

Citizens has adopted a Code of Ethics that applies to all employees, including its executive officers. In the event that Citizens makes any amendment to, or grants any waivers of, a provision of the Code of Ethics that applies to the principal executive officer, principal financial officer or principal accounting officer that requires disclosure under applicable SEC rules, the company intends to disclose such amendment or waiver and the reasons therefore, and Citizens will disclose the nature of such amendment or waiver in a report on Form 8-K. Citizens' Code of Ethics may be viewed by accessing our website at [www.cnbelkins.com](http://www.cnbelkins.com).

#### Item 11. Executive Compensation

##### **Compensation Discussion and Analysis**

**Executive Compensation:** The executive officers of Citizens Financial Corp. serve without compensation from the company. Those serving as officers of the subsidiary bank are compensated by the bank for that service, however. The company does not provide any performance-based compensation, such as bonuses or equity awards, to any level of management. Senior management compensation is comprised of a salary that is established to be competitive with banks of a comparable asset size and in a comparable market. The company believes that a comparable asset size ranges from \$100 to \$500 million and a comparable market would include banks in West Virginia and the contiguous states. Comparative information is derived from a 2004 West Virginia Bankers Association salary survey of banks in West Virginia with assets ranging from \$100 to \$499 million. The company also referenced a 2005 salary survey purchased from Crowe Human Resource Consulting Group; this survey includes banks in Ohio with assets ranging from \$200 to \$500 million. In addition to the reference material just described, consideration is also given cost of living factors. This process is consistent with that used to determine the compensation levels of all other employees. Annual salary increases for all employees become effective after the annual stockholder's meeting in April each year.

The principal executive officer of the corporation serves without compensation from the bank or the company. He is currently retired from the bank and receives fees for his role as a director of the company, as well as from retirement plan distributions.

In April, 2006 the annual salary of the bank's principal financial officer was set at \$125,000 through the process described in the paragraph above. In addition, the annual salary for the bank's chief executive officer was set at \$135,000 in April. The bank's chief executive officer also serves on the board of directors and receives board fees for his service in that capacity.

**Board Personnel Committee:** Compensation of the bank's chief executive officer and the bank's principal financial officer is determined independently by the personnel committee of the board of directors. The committee is comprised of five independent directors. The committee sets these officers' salaries subjectively using the process described in the preceding paragraphs without any participation by the chief executive officer or the principal financial officer. The committee then meets with the bank's chief executive officer and bank's principal financial officer to set the remaining executive officers' salaries, as well as, the other officers of the bank.

**Retirement Plans:** Citizens Financial Corp., having no employees, has no retirement program, but Citizens National Bank has a pension program for its eligible employees. This pension plan is a qualified retirement plan and is available to all employees, including officers, who meet the eligibility requirements. Directors do not participate in this plan. Additional information regarding the plan is contained in Note 11 to the accompanying consolidated financial statements.

The bank has established a 401(k) plan for the benefit of all employees who meet eligibility requirements. A description of the Plan, the eligibility requirements and the contributions made to the Plan by the bank for the years ended December 31, 2006, 2005 and 2004 may be found in Note 11 to the accompanying consolidated financial statements.

The bank entered into a nonqualified supplemental income plan with certain senior officers as described in Note 11 to the accompanying consolidated financial statements. A copy of the plan, and the amendments thereto, are incorporated herein by reference to the exhibits contained in the company's Forms 10-K dated December 31, 1997 and 1996. The plan was originally established for certain key officers after the employee pension plan benefit calculations were revised and benefits were reduced. This plan was purchased to recuperate the lost retirement income the officers had suffered through the pension modification.

Also as explained in Note 11, effective January 1, 2003, the bank entered into another nonqualified executive and director supplemental retirement plan with its directors and those officers who qualified. A copy of the plan is incorporated

herein by reference to Exhibit 10 contained in the company's Form 10-K dated December 31, 2003. This plan was designed to reward directors and key officers for their service on a basis consistent with that of many of our competitors.

Additional details regarding the pension, 401K, and supplemental retirement plans are provided below with the Pension Benefits Table and Nonqualified Deferred Compensation Table

**Other Benefits:** Senior management also participates in the bank's other benefit plans on the same terms as other employees. These plans include medical insurance, life insurance, and discounts on bank products.

**Change in Control:** No employment contracts exist between any executive officer and the registrant, or its subsidiary. However, the executive supplemental income plan and the executive and director supplemental retirement plan described above both contain a change in control clause.

Under the executive supplemental income plan, if a change in control occurs and the executive voluntarily terminates his position, is permanently disabled, or is discharged without just cause he is entitled to receive full benefits under this plan up beginning at the early retirement age (62) without satisfying any minimum years of service requirement. The monthly retirement benefit for Mr. Schoonover, Mr. Johnson, and Mr. Derbyshire is \$755, \$669, and \$1,069, respectively.

Under the executive and director supplemental retirement plan, if there is a change in control and the executive is subsequently terminated without cause, the benefits to be received under the plan vest as if the executive had worked for the company until normal retirement age. The executive will continue to accrue benefits based on the original benefit formula and will receive benefits upon attaining normal retirement age.

Additional information related to the material terms of these two retirement plans are included in the discussion after the Pension Benefits Table below.

On March 14, 2007, the board of directors of Citizens Financial Corp. appointed William T. Johnson, Jr. acting President and CEO. This appointment was deemed necessary due to the illness of the company's permanent CEO, Robert J. Schoonover. Mr. Schoonover served as President and CEO of the company for the entire 2006 year, and he is expected to return to his normal duties when his health permits. In this regard, Mr. Schoonover is included in this discussion and the tabular presentation below as the President and CEO. Additional information regarding Mr. Johnson's appointment can be found in our Form 8-K filing dated March 14, 2007.

The following table sets forth the compensation of the company's Principal Executive Officer and Principal Financial Officer, as well as, that of other officers who received total annual compensation exceeding \$100,000.

#### SUMMARY COMPENSATION TABLE

| Name and Principal Position  | Year | Salary (\$) | Change in Pension Value and Nonqualified Deferred Compensation Earnings (1) | All Other Compensation (2) (3) | Total     |
|--|------|-------------|---|--------------------------------|-----------|
| Robert J. Schoonover,<br>President & CEO<br>Citizens Financial Corp and<br>Citizens National Bank                | 2006 | \$ -        | N/A   | \$110,458                      | \$110,458 |
| William T. Johnson, Jr.<br>VP, Citizens Financial Corp.<br>President & CEO,<br>Citizens National Bank            | 2006 | 126,356     | \$70,050  | 16,927                         | 212,333   |
| Thomas K. Derbyshire<br>VP & Treasurer,<br>Citizens Financial Corp.<br>EVP, SVP & CFO,<br>Citizens National Bank | 2006 | 120,113     | 13,018  | 5,851                          | 138,982   |

(1) Since Mr. Schoonover is retired from the bank, he receives payments from his pension and other supplemental

plans. The payment of such benefits results in a decrease in the value of his pension and nonqualified deferred compensation plan, therefore it has been excluded from the table above. He participates in the employee pension plan, executive supplemental income plan, and the executive and director supplemental retirement plan; the change in the values of those plans was \$(16,248), \$(15,516), and \$(26,711), respectively.

- (2) Mr. Schoonover and Mr. Johnson also serve as members of the board of directors. In 2006, for his services as a director, Mr. Schoonover received director fees of \$22,279 for board and committee meetings, as well as other compensation totaling \$28,228 which included \$20,004 for consulting fees and the remainder for insurance premiums paid for the benefit of the director. In 2006, Mr. Johnson received \$9,319 in director fees for his services on the board.
- (3) In addition to the board fees described in the preceding footnote, this column includes the company's contributions to the individual's 401(k) retirement savings program to which the individual has a vested interest and taxable income resulting from participation in a bank sponsored executive and director supplemental retirement plan. The bank's group life and health insurance program, which is paid for by the bank, is made available to all full-time employees and does not discriminate in favor of directors or officers; however, in accordance with IRS Code Section 79, the cost of group term life insurance coverage for an individual in excess of \$50,000 is added to the individual's earnings and is also included in this figure. Since Mr. Schoonover is retired from the bank his figure also includes \$30,466 received from the employee pension, \$9,061 received from the executive supplemental income plan, \$20,424 received from the executive and director supplemental retirement plan.

### PENSION BENEFITS TABLE

| Name                    | Plan Name  | Number of Years Credited Service | Present Value of Accumulated Benefit (\$) | Payments During Last Fiscal Year (\$) |
|-------------------------|--|----------------------------------|---|---------------------------------------|
| Robert J. Schoonover    | Employee Pension                                   | 32                               | \$394,868                                 | \$30,466                              |
|                         | Executive Supplemental Income Executive & Director | 32                               | 83,025                                    | 9,061                                 |
|                         | Supplemental Retirement                            | 32                               | <u>157,590</u>                            | <u>20,424</u>                         |
|                         | Total  |                                  | 635,483                                   | 59,951                                |
| William T. Johnson, Jr. | Employee Pension                                   | 46                               | 308,001                                   | N/A                                   |
|                         | Executive Supplemental Income Executive & Director | 46                               | 79,229                                    | N/A                                   |
|                         | Supplemental Retirement                            | 46                               | <u>71,353</u>                             | <u>N/A</u>                            |
|                         | Total  |                                  | 458,583                                   | N/A                                   |
| Thomas K. Derbyshire    | Employee Pension                                   | 15                               | 50,333                                    | N/A                                   |
|                         | Executive Supplemental Income Executive & Director | 15                               | 36,935                                    | N/A                                   |
|                         | Supplemental Retirement                            | 15                               | <u>4,611</u>                              | <u>N/A</u>                            |
|                         | Total  |                                  | 91,879                                    | N/A                                   |

The bank's defined benefit pension plan covers all employees who meet the eligibility requirements. To be eligible, an employee must be 21 years of age and have completed one year/1,000 hours of continuous service. Our funding policy is to make annual contributions as permitted or required by applicable regulations. Pensions for all participants are based on five-year average final compensation. Credits are received for each year of participation at the following rates: 1 percent of the first \$9,600 of the 5-year average final compensation and 1.5 percent of such average final compensation in excess of \$9,600, all multiplied by years of service up to a 25-year maximum. The pension benefits are payable to participants on a monthly basis in the form of a joint and 50 percent survivor annuity for all married participants who do not elect otherwise, or in the form of a single life annuity for all other participants or survivors. Joint and 100 percent survivorship, single life annuity or 120 payments guaranteed are other optional forms of distribution. Under the plan, the normal retirement age is 65. However, an employee can retire beginning at age 60 and received full benefits based on the same formula described above using their current years of service and last five years of compensation. Mr. Johnson is eligible to retire under the early retirement provisions of this plan.

The executive supplemental income plan is a nonqualified retirement plan provided to certain key executives. The plan was written to allow the recuperation of retirement income lost by these executives when the pension was modified and benefits were reduced. Normal retirement age under the plan is 65. However, executives can receive 100% of their retirement benefit if they retire early after age 62 and have completed 30 years of service. This deferred compensation plan calls for 180 equal monthly payments to be paid beginning after retirement. The monthly retirement benefit for Mr. Schoonover, Mr. Johnson, and Mr. Derbyshire is \$755, \$669, and \$1,069, respectively. These payment amounts were determined at plan inception as a direct result of the benefits lost in the pension modification. Mr. Schoonover is currently receiving benefits under the plan, and Mr. Johnson is currently qualified to retire under the early retirement provisions.

Additional information related to the plan is contained in the Deferred Compensation Table below.

The executive and director supplemental retirement plan is a nonqualified retirement plan provided to certain key executives and the directors of the bank. Benefits paid under the plan (if any) are the result of excess after-tax earnings of certain life insurance contracts purchased by the bank over a defined opportunity cost. The opportunity cost is defined as a rolling 5 year average of the 3 year Treasury bill. The excess earnings are used to compute a retirement benefit that is recorded in a pre-retirement account as a liability on books of the registrant for each plan year. The change in the pre-retirement benefit is included in the nonqualified deferred compensation table below under the caption *Company Contributions in 2006*. Upon retirement of an executive, the balance in the pre-retirement account is paid to the executive in 120 monthly installments or until the executive's death. In addition to these payments, the retiree also receives the additional excess earnings for each plan year subsequent to his retirement until death. These excess earnings are calculated using the same formula as described in this paragraph. The plan defines normal retirement age as 65, but an executive can retire with 100% of his benefits at age 62 if he has 30 years of service with the company. If the executive retires or leaves employment before he is age 65 and does not have 30 years of service, he will receive no benefit from the plan. Mr. Schoonover receives benefits from this plan, and Mr. Johnson is currently qualified to retire under this plan with full benefits. The plan also includes a death benefit for each executive. If an executive dies before retirement, his designee will receive a death benefit of two and one half times the executive's final pre-tax gross salary. If the executive dies after retirement, his designee will receive a \$100,000 death benefit. In either case, the executive's designee also receives any remaining retirement benefit as well. Additional information related to the executive and director supplemental retirement plan is provided in the table below.

#### NONQUALIFIED DEFERRED COMPENSATION TABLE (1)

| Name                    | Company Contributions in 2006 (2) | Aggregate Withdrawals/ Distributions (3) | Aggregate Balance at December 31, 2006 (3) |
|-------------------------|-----------------------------------|--|--|
| Robert J. Schoonover    | N/A                               | \$29,485                                 | \$240,615                                  |
| William T. Johnson, Jr. | \$21,572                          | N/A                                      | 150,582                                    |
| Thomas K. Derbyshire    | 5,664                             | N/A                                      | 41,546                                     |

- (1) This table includes the summary information for both the executive supplemental income plan and the executive and director supplemental retirement plan.
- (2) Amounts reported as company contributions in 2006 were also reported in the above Summary Compensation Table column titled *Change in Pension Value and Nonqualified Deferred Compensation Earnings*.
- (3) The distributions and the aggregate balances reported in these columns are also reported in the Pension Benefits Table above.

#### DIRECTOR COMPENSATION

| Name               | Fees Earned or Paid in Cash | Change in Pension Value and Nonqualified Deferred Compensation Earnings | All Other Compensation (1) | Total   |
|--------------------|-----------------------------|---|----------------------------|---------|
| Robert N. Alday    | \$ 700                      | \$ -  | \$ -                       | \$ 700  |
| Max L. Armentrout  | 20,899                      | 46,537  | 37,694                     | 105,130 |
| William J. Brown   | 19,779                      | 2,923   | 11,017                     | 33,719  |
| Edward L. Campbell | 13,239                      | 7,758   | 10,812                     | 31,809  |
| John F. Harris     | 18,819                      | 17,575  | 22,127                     | 58,521  |
| Cyrus K. Kump      | 21,649                      | 2,573   | 11,017                     | 35,239  |
| L.T. Williams      | 21,239                      | 11,194  | 252                        | 32,685  |
| John A. Yeager     | 12,539                      | 571   | 594                        | 13,704  |

- (1) For their service, Mr. Armentrout and Mr. Harris received consulting fees of \$26,784 and \$21,875, respectively. The bank paid health insurance premiums for Mr. Armentrout, Mr. Brown, Mr. Campbell, and Mr. Kump in the amount of \$10,255 per person.

The table above includes all directors of Citizens Financial Corp, except for Robert J. Schoonover and William T. Johnson, Jr. who also serve as executive officers. With the exception of Mr. Alday, each director also serves on the board

for Citizens National Bank. The table includes compensation from the company and the subsidiary bank. There are four additional directors excluded from the table above that only serve on the board for Citizens National Bank. The bank directors, Dickson W. Kidwell, Franklin M. Santmyer, Jr., Thomas A. Wamsley, and C. Curtis Woodford earned total compensation of \$26,430, \$13,406, \$25,015, and \$11,457, respectively.

Directors of the registrant are compensated for meetings attended in the amount of \$100 per meeting. Directors of the bank receive \$663 per meeting. Under normal circumstances, the Board of Citizens Financial Corp. meets quarterly while the Citizens National Bank Board meets monthly. Directors also receive monthly fees for serving on and attending the meetings of various committees such as the loan committee, audit committee, or compliance committee. Directors do not participate in the bank's pension plan. However, they do participate in the executive and director supplemental retirement plan. The benefit calculation of the plan for the directors is substantially the same as the officers, except their vesting period to receive benefits is 15 years, normal retirement age is 70 and their death benefit is \$100,000 regardless of retirement status. The amount of earnings allocated to each director under this plan is included in the above table.

Also included in the Other Compensation column above are insurance premiums paid by the bank for benefit of the directors, as well as consulting fees. The chairman of Citizens Financial Corp., Max L. Armentrout was paid a consulting fee of \$26,784 by the bank and the senior vice-president of the bank, John F. Harris, received \$21,875 for his services.

#### Item 12. Security Ownership of Certain Beneficial Owners and Management

The company does not have any plan that provides for the issuance of any securities under equity compensation plans.

The company has one shareholder, Max L. Armentrout, who is the beneficial owner of more than 5% of the company's common stock, the only class of stock outstanding, as of February 28, 2007. Mr. Armentrout, who is chairman of the board of directors of the company, beneficially owns 92,455 shares or 5.05% of the outstanding stock. His direct and indirect ownership is disclosed in the table below.

The following table sets forth the amount and percentage of stock of Citizens Financial Corp. beneficially owned by each director and executive officer of the company, and by all directors and executive officers as a group, as of February 28, 2007.

| <u>Name</u>  | <u>Shares of Stock Beneficially Owned</u> |                 |              | <u>Percent of Ownership</u> |
|--|---|-----------------|--------------|-----------------------------|
|  | <u>Direct</u>                             | <u>Indirect</u> | <u>Total</u> |                             |
| Max L. Armentrout<br>PO Box 1758<br>Elkins, WV 26241 | 77,980                                    | 14,475 (1)      | 92,455       | 5.05%                       |
| Robert N. Alday                                      | 1,500                                     | 60,600 (2)      | 62,100       | 3.39%                       |
| William J. Brown                                     | 2,250                                     | 3,150 (3)       | 5,400        | 0.30%                       |
| Edward L. Campbell                                   | 1,500                                     | 450 (4)         | 1,950        | 0.11%                       |
| John F. Harris                                       | 7,575                                     | 16,500 (5)      | 24,075       | 1.32%                       |
| William T. Johnson, Jr.                              | 1,500                                     | 8,454 (6)       | 9,954        | 0.54%                       |
| Cyrus K. Kump  | 1,500                                     | 6,850 (7)       | 8,350        | 0.46%                       |
| Robert J. Schoonover                                 | 1,500                                     | 300 (8)         | 1,800        | 0.10%                       |
| L. T. Williams                                       | 5,250                                     | 0               | 5,250        | 0.29%                       |
| John A. Yeager                                       | 5,025                                     | 0               | 5,025        | 0.27%                       |
| Thomas K. Derbyshire                                 | 210                                       | 0               | 210          | 0.01%                       |
| Directors and executive officers of the Bank         | 10,935                                    | 10,740          | 21,675 (9)   | 1.18%                       |
| All Directors and executive officers as a group      | 116,725                                   | 121,519         | 238,244      | 13.02%                      |

(1) These 14,475 shares are owned by Mr. Armentrout's wife.

(2) Mr. Alday's indirect ownership includes 20,400 shares owned by his wife and 40,200 shares which he votes for the Phil Williams Coal Company. The 40,200 shares he votes for the Phil Williams Coal Company are also pledged

as collateral for a loan made in the normal course of business by the subsidiary bank.

(3) Includes 750 shares owned jointly with his wife, 1500 shares held in custody for their children, and 900 shares owned by Mr. Brown's brother and sister-in-law.

(4) Includes 300 shares owned jointly with his wife and 150 shares owned by his wife.

(5) These 16,500 shares are owned jointly with his wife.

(6) Includes 5,634 shares owned jointly with his wife and 2,820 shares owned by his wife.

(7) Includes 3,850 shares owned by his wife and 3,000 shares held in custody for their children.

(8) These 300 shares are owned jointly with his wife.

(9) This figure represents the ownership of persons who are directors of the subsidiary bank but not of the company. Such persons number four.

### Item 13. Certain Relationships and Related Transactions and Director Independence

Management personnel of Citizens Financial Corp. have had and expect to continue to have banking transactions with Citizens National Bank in the ordinary course of business. Extensions of credit to such persons are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. It is the opinion of management that these transactions do not involve more than a normal risk of collectibility or present other unfavorable features.

As of December 31, 2006, outstanding loan balances to related parties totaled \$6,111,725 or 30.0% of equity capital with unused lines of credit of \$1,617,962 or 7.9% of the equity capital of Citizens Financial Corp. outstanding to these parties.

Other than loans originated in the normal course of business by the Bank, none of the directors, executive officers, 5 percent or more beneficial stockholders or their immediate family members have an interest or are involved in any transactions with Citizens Financial Corp. or Citizens National Bank in which the amount involved exceeds \$120,000, or was not subject to the usual terms or conditions, or was not determined by competitive bids. Information related to loans granted to related parties in excess of \$120,000 is contained in Note 5 to the accompanying consolidated financial statements. Similarly, no director, executive officer or 5 percent or more beneficial stockholder has an equity interest in excess of 10 percent in a business or professional entity that has made payments to or received payments from Citizens Financial Corp. or Citizens National Bank in 2006 which exceeds 5 percent of either party's gross revenue.

### Item 14. Principal Accounting Fees and Services

As disclosed in our Form 8-K filing dated November 26, 2003, we changed principal accountants in 2004 with the engagement of Yount, Hyde and Barbour. Fees for services provided by our principal accountants are provided below:

|                    | <u>2006</u> | <u>2005</u> |
|--------------------|-------------|-------------|
| Audit Fees         | \$39,050    | \$37,775    |
| Audit-Related Fees | 7,647       | 6,222       |
| Tax Fees           | 5,600       | 4,800       |
| All Other Fees     | -           | -           |

Audit fees consist of fees for professional services rendered for the audit of the Company's financial statements and review of financial statements included in the Company's quarterly reports. Audit-related fees are primarily related to consultations concerning financial accounting and reporting standards. Tax fees consist of compliance fees for the preparation of original tax returns and fees for tax consulting services.

The Audit Committee Charter requires that the audit committee pre-approve all audit and non-audit services to be provided to Citizens by the independent accountants; provided, however, that the audit committee may specifically authorize its chairman to pre-approve the provision of any non-audit service to the company. Further, the foregoing pre-approved policies may be waived, with respect to the provision of any non-audit services consistent with the exceptions for

federal securities law. All of the audit, audit related, and tax services described above were pre-approved by the audit committee.

#### Part IV

##### Item 15. Exhibits and Financial Statements Schedules

- (a) (1) and (2) Financial Statements and Financial Statement Schedules.  
All financial statements and financial statement schedules required to be filed by Item 8 of this Form or by Regulation S-X which are applicable to the registrant have been presented in the financial statements, notes thereto, in management's discussion and analysis of financial condition and results of operations or elsewhere where appropriate.
- (3) The following is a list of all exhibits filed as part of this report:

## INDEX TO EXHIBITS

- 3 (i) The company's Articles of Incorporation, which were previously filed as amended on pages 23-35 of its Form 10-Q dated March 31, 2006, are incorporated herein by reference.
- 3 (ii) The company's Bylaws, which were previously filed as amended on pages 36-41 of its Form 10-Q dated March 31, 2006, are incorporated herein by reference.
- 4 The rights of security holders are defined in the Articles of Incorporation which were previously filed as amended on pages 66-70 of our Form 10-K dated December 31, 1999 which is incorporated herein by reference.
- 10 The following material contracts are incorporated by reference into this filing:
  - 1) The bank's Executive Supplemental Income Agreement as previously filed on pages 74-80 of the company's Form 10-K dated December 31, 1995 and thereafter amended and filed on page 62 of the company's Form 10-K dated December 31, 1996.
  - 2) The bank's Purchase and Assumption Agreement with South Branch Valley National Bank for the purchase of its banking facilities, assets and liabilities located in Petersburg, West Virginia dated December 17, 1999 and filed on pages 71-113 of the company's Form 10-K dated December 31, 1999.
  - 3) The bank's Supplemental Retirement and Split Dollar Life Insurance plans for executives and directors dated January 1, 2003 and previously filed on pages 75-110 of its Form 10-K dated December 31, 2003.
- 11 The computation of per share earnings may be clearly determined by the material contained in this filing.
- 12 The computation of minimum standard capital ratios, as contained in this report, was done as specified in applicable regulatory guidelines. All other ratios presented may be clearly determined from the material contained in this filing.
- 14 The company's Code of Ethics, which is applicable to all employees of the company and its subsidiary, including the principal executive officer and principal accounting officer, has been made available on the company's website, [www.cnbelkins.com](http://www.cnbelkins.com), and is, therefore, not filed as part of this Form 10-K.
- 21 List of subsidiaries of the registrant (filed herewith).
- 23 Consent of Yount, Hyde and Barbour, P.C. (filed herewith).
- 31.01 Certification of the Principal Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 31.02 Certification of the Principal Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
- 32.01 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 (filed herewith).
- 32.02 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 (filed herewith).
- 99 Notice of Annual Meeting of Stockholders and Proxy
- (b) Exhibits required by item 601 of Regulation S-K-all applicable exhibits have been filed as detailed in the Index to Exhibits. Exhibits contained in item 601 of Regulation S-K but not contained in the Index are not applicable or are not required in Form 10-K.

## Signatures

Pursuant to the requirements of Section 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Citizens Financial Corp.

By /s/ William T. Johnson, Jr.  
 William T. Johnson, Jr.  
 Acting President and Chief Executive Officer

Date: 3/28/07

By /s/ Thomas K. Derbyshire  
 Thomas K. Derbyshire  
 Treasurer and Principal Financial Officer

Date: 3/28/07

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

| <u>Signature</u>  | <u>Title</u>                          | <u>Date</u>    |
|---|---------------------------------------|----------------|
| <u>/s/ Max L. Armentrout</u><br>Max L. Armentrout             | Chairman of the Board<br>and Director | <u>3/28/07</u> |
| <u>Robert N. Alday</u>  | Director                              | <u>3/28/07</u> |
| <u>/s/ William J. Brown</u><br>William J. Brown               | Director                              | <u>3/28/07</u> |
| <u>/s/ Edward L. Campbell</u><br>Edward L. Campbell           | Director                              | <u>3/28/07</u> |
| <u>John F. Harris</u>   | Director                              | <u>3/28/07</u> |
| <u>/s/ William T. Johnson, Jr.</u><br>William T. Johnson, Jr. | Director                              | <u>3/28/07</u> |
| <u>/s/ Cyrus K. Kump</u><br>Cyrus K. Kump                     | Director                              | <u>3/28/07</u> |
| <u>Robert J. Schoonover</u>                                   | Director                              | <u>3/28/07</u> |
| <u>/s/ L. T. Williams</u><br>L. T. Williams                   | Director                              | <u>3/28/07</u> |
| <u>/s/ John A. Yeager</u>                                     | Director                              | <u>3/28/07</u> |

John A. Yeager

**SUPPLEMENTAL INFORMATION TO BE FURNISHED WITH REPORTS FILED PURSUANT TO  
SECTION 15 (d) OF THE ACT BY REGISTRANTS WHICH HAVE NOT REGISTERED SECURITIES  
PURSUANT TO SECTION 12 OF THE ACT**

The entire annual report and proxy materials mailed to the company's stockholders has been furnished to the Commission for its information under separate cover, in paper format, concurrent with submission to stockholders on March 21, 2007.

**LIST OF SUBSIDIARIES OF CITIZENS FINANCIAL CORP.**

Citizens Financial Corp., the registrant herein, certifies that it has one wholly-owned subsidiary as of December 31, 2006 which is Citizens National Bank of Elkins, Randolph County, West Virginia, a national banking association incorporated in the state of West Virginia.

Consent of Independent Registered Public Accounting Firm

Securities and Exchange Commission  
Washington, D. C.

We hereby consent to the inclusion in this Annual Report on Form 10-K of our report dated March 9, 2007, on our audit of the consolidated financial statements of Citizens Financial Corp. as of December 31, 2006 and for the year then ended appearing in Part II, Item 8 of the 2005 Form 10-K of Citizens Financial Corp.

/s/ YOUNT, HYDE & BARBOUR P.C.

Winchester, Virginia  
March 28, 2007

**Citizens Financial Corp.  
Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, William T. Johnson, Jr., Acting President and Chief Executive Officer of Citizens Financial Corp., certify that:

1. I have reviewed this annual report on Form 10-K of Citizens Financial Corp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results in operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date 3/28/07

/s/ William T. Johnson, Jr.  
William T. Johnson, Jr.  
Acting President and Chief Executive Officer

**Citizens Financial Corp.  
Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Thomas K. Derbyshire, Vice President, Treasurer and Principal Financial Officer of Citizens Financial Corp., certify that:

1. I have reviewed this annual report on Form 10-K of Citizens Financial Corp;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results in operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: 3/28/07

/s/ Thomas K. Derbyshire  
Thomas K. Derbyshire  
V.P., Treasurer & Principal Financial Officer

**Citizens Financial Corp.**

**Certification Pursuant to Section 906 of the Sarbanes-Oxley  
Act of 2002, 18 U.S.C. Section 1350**

I, William T. Johnson, Jr., Acting President and Chief Executive Officer of Citizens Financial Corp. (the "company") certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 that:

1. the Annual Report on Form 10-K of the company for the annual period ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the company.

Date: 3/28/07

/s/ William T. Johnson, Jr.  
Acting President and  
Chief Executive Officer

**Citizens Financial Corp.**

**Certification Pursuant to Section 906 of the Sarbanes-Oxley  
Act of 2002, 18 U.S.C. Section 1350**

I, Thomas K. Derbyshire, Vice President, Treasurer and Principal Financial Officer of Citizens Financial Corp. (the "company") certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 that:

1. the Annual Report on Form 10-K of the company for the annual period ended December 31, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the company.

Date: 3/28/07

/s/Thomas K. Derbyshire  
Vice President, Treasurer and  
Principal Financial Officer

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD APRIL 21, 2007**

TO THE STOCKHOLDERS OF CITIZENS FINANCIAL CORP.:

Notice is hereby given that the Annual Meeting of Stockholders of Citizens Financial Corp. will be held in the lobby of the Citizens National Bank of Elkins, 211-213 Third Street, Elkins, West Virginia, on Saturday, April 21, 2007, at 11:00 A.M., for the purpose of voting on the following matters:

1. To fix the maximum number of Directors at ten (10).
2. To elect three (3) Directors to serve a full three-year term expiring in 2010. The nominees are: William J. Brown; Edward L. Campbell; and Robert J. Schoonover.

In addition to the foregoing nominees, the following seven (7) persons presently are serving as members of the Board of Directors, for terms to expire in the year indicated for each member: Robert N. Alday (2009); Max L. Armentrout (2008); John F. Harris (2008); William T. Johnson, Jr. (2008); Cyrus K. Kump (2009); L. T. Williams (2008); and John A. Yeager (2009).

3. To conduct such other business as may properly come before the meeting or any adjournment thereof.

Stockholders of record as of the close of business on March 1, 2007 are entitled to notice and to vote at the meeting. A majority of the outstanding capital stock represented in person or by proxy shall constitute a quorum at the meeting. Each of the matters to be voted on shall be decided by a majority of the votes cast.

I urge you to sign and date the enclosed proxy and return it at once in the enclosed envelope. Proxies may be revoked at any time before the shares subject to it are voted by:

1. Providing written notice to Leesa M. Harris, Secretary, Citizens Financial Corp., PO Box 1519, Elkins, WV 26241 or
2. Executing a proxy bearing a later date or
3. Voting in person at the annual meeting the shares represented by the proxy (your attendance at the annual meeting will not by itself revoke your proxy; you must vote in person at the annual meeting).

By Order of the Board of Directors.

Sincerely,

Leesa M. Harris  
Secretary

March 9, 2007

**PROXY**

**CITIZENS FINANCIAL CORP.  
ANNUAL MEETING OF STOCKHOLDERS-SATURDAY, APRIL 21, 2007**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS  
OF CITIZENS FINANCIAL CORP.**

John A. Yeager, Carl Antolini, Jr., and Ann W. Knotts Harris, or any of them, each with all the powers and discretion the undersigned would have if personally present, are hereby appointed to represent the undersigned, with full power of substitution, at the Annual Meeting of Stockholders of Citizens Financial Corp. to be held on April 21, 2007 (including any adjournments or postponements thereof), and to vote all shares of stock of Citizens Financial Corp. which the undersigned is entitled to vote on all matters that properly come before the meeting, subject to any directions indicated in the boxes below.

This Proxy shall be voted as follows (MANAGEMENT RECOMMENDS A VOTE "FOR" EACH OF THE FOLLOWING):

**1. FIX THE MAXIMUM NUMBER OF DIRECTORS AT TEN (10)**

FOR  AGAINST  ABSTAIN

**2. ELECTION OF THREE (3) CLASS 3 DIRECTORS (To serve three-year terms until the Annual Meeting of Stockholders to be held in April, 2010)**

FOR ALL NOMINEES LISTED BELOW  AGAINST ALL NOMINEES LISTED BELOW

(INSTRUCTION: To vote against any individual nominee, strike a line through the nominee's name in the list below)

William J. Brown  
Edward L. Campbell  
Robert J. Schoonover

**3. In the discretion of the Proxy representatives, to vote with respect to other matters that may come before the meeting or any adjournment thereof.**

THIS PROXY WILL, WHEN PROPERLY EXECUTED, BE VOTED AS DIRECTED. IF NO DIRECTIONS TO THE CONTRARY ARE INDICATED IN THE BOXES PROVIDED, THE REPRESENTATIVES WILL VOTE "FOR" THE ABOVE LISTED PROPOSALS.

DATED this \_\_\_ day of \_\_\_\_\_, 2007 (Please date this Proxy).

\_\_\_\_\_  
*Signature of Registered Owner*

\_\_\_\_\_  
*Signature of Registered Owner*

Number of Shares Held:\_\_\_\_\_

When signing as attorney, executor, administrator, trustee, or guardian, please give full title. If more than one trustee, all should sign. All joint owners must sign.

**PLEASE DATE AND SIGN THIS PROXY AND RETURN IT PROMPTLY IN THE ENCLOSED ENVELOPE.**