FIRST KEYSTONE CORP
Form 10-Q
August 07, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2009

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

For the transition period from ________ to ________

Commission File Number: 2-88927

FIRST KEYSTONE CORPORATION
(Exact name of registrant as specified in its charter)

PENNSYLVANIA	23-2249083
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer identification No.)

111 WEST FRONT STREET, BERWICK, PA	18603
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (570) 752-3671

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 [X] No [ ]

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

Large accelerated filer	[ ]
Accelerated filer	[X]
Non-accelerated filer	[ ]
Smaller reporting company	[ ]

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

Yes [ ]   No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date:

Common Stock, $2 Par Value, 5,440,126 shares as of August 6, 2009.

PART I. - FINANCIAL INFORMATION

ITEM. 1 Financial Statements

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)

	June 2009 (Unaudited)	December 2008
ASSETS		
Cash and due from banks	$ 5,940	$ 9,945
Interest-bearing deposits in other banks	16,357	6
Investment securities available-for-sale carried at estimated fair value	243,261	240,175
Investment securities, held-to-maturity securities, estimated fair value 2009 $4,911 and 2008 $2,906	4,982	2,990
Loans, net of unearned income	409,019	408,367
Allowance for loan losses	(5,225)	(5,195)
Net loans	$403,794	$403,172
Premises and equipment - Net	10,771	9,169
Accrued interest receivable	4,162	4,228
Cash surrender value of bank owned life insurance	17,247	17,157
Goodwill	19,133	19,133
Other assets	9,320	8,923
TOTAL ASSETS	$734,967	$714,898
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Non-interest bearing	$ 58,781	$ 58,178
Interest bearing	500,647	446,455
TOTAL DEPOSITS	$559,428	$504,633
Short-term borrowings	18,582	55,332

Long-term borrowings	82,020	82,062
Accrued interest and other expenses	3,655	3,488
Other liabilities	112	236
TOTAL LIABILITIES	$663,797	$645,751
STOCKHOLDERS' EQUITY		
Common stock, par value $2 per share	$ 11,375	$ 11,375
Surplus	30,269	30,269
Retained earnings	40,177	38,414
Accumulated other comprehensive (loss)	(4,411)	(4,671)
Less treasury stock at cost 247,641 shares in 2009 and 2008	(6,240)	(6,240)
TOTAL STOCKHOLDERS' EQUITY	$ 71,170	$ 69,147
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$734,967	$714,898

See Accompanying Notes to Consolidated Financial Statements

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FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED JUNE 30, 2009 AND 2008
(Unaudited)

(Amounts in thousands except per share data)

	2009	2008
INTEREST INCOME		
Interest and fees on loans	$6,220	$6,308
Interest and dividend income on securities	3,183	2,908
Deposits in banks	3	51
TOTAL INTEREST INCOME	$9,406	$9,267
INTEREST EXPENSE		
Deposits	$2,887	$3,556
Short-term borrowings	79	110
Long-term borrowings	984	880
TOTAL INTEREST EXPENSE	$3,950	$4,546
Net interest income	$5,456	$4,721
Provision for loan losses	175	75

NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	$5,281	$4,646
NON-INTEREST INCOME		
Trust department	$ 103	$ 132
Service charges and fees	589	608
Bank owned life insurance income	189	172
Gain on sale of loans	96	0
Investment securities gains (losses) - net	7	19
Other	326	67
TOTAL NON-INTEREST INCOME	$1,310	$ 998
NON-INTEREST EXPENSE		
Salaries and employee benefits	$1,975	$1,777
Occupancy, net	285	271
Furniture and equipment	322	233
Professional services	86	85
State shares tax	174	170
FDIC Insurance	593	25
Other	725	787
TOTAL NON-INTEREST EXPENSES	$4,160	$3,348
Income before income taxes	$2,431	$2,296
Income tax expense	268	410
Net Income	$2,163	$1,886
PER SHARE DATA		
Net Income Per Share:		
Basic	$ .39	$ .34
Diluted	.39	.34
Cash dividends per share	.23	.22

See Accompanying Notes to Consolidated Financial Statements

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND 2008
(Unaudited)

(Amounts in thousands except per share data)

	2009	2008

INTEREST INCOME		
Interest and fees on loans	$12,405	$12,678
Interest and dividend income on securities	6,361	5,860
Deposits in banks	3	66
Interest on fed funds sold	0	14
TOTAL INTEREST INCOME	$18,769	$18,618
INTEREST EXPENSE		
Deposits	$ 5,827	$ 7,345
Short-term borrowings	201	326
Long-term borrowings	1,957	1,728
TOTAL INTEREST EXPENSE	$ 7,985	$ 9,399
Net interest income	$10,784	$ 9,219
Provision for loan losses	450	125
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	$10,334	$ 9,094
NON-INTEREST INCOME		
Trust department	$ 226	$ 284
Service charges and fees	1,134	1,186
Bank owned life insurance income	373	341
Gain on sale of loans	96	42
Investment securities gains (losses) - net	133	123
Other	384	127
TOTAL NON-INTEREST INCOME	$ 2,346	$ 2,103
NON-INTEREST EXPENSE		
Salaries and employee benefits	$ 3,867	$ 3,653
Occupancy, net	570	536
Furniture and equipment	544	445
Professional services	171	196
State shares tax	346	340
FDIC Insurance	775	53
Other	1,403	1,575
TOTAL NON-INTEREST EXPENSES	$ 7,676	$ 6,798
Income before income taxes	$ 5,004	$ 4,399
Income tax expense	739	791
Net Income	$ 4,265	$ 3,608
PER SHARE DATA		
Net Income Per Share:		
Basic	$ .78	$ .66
Diluted	.78	.66
Cash dividends per share	.46	.44

See Accompanying Notes to Consolidated Financial Statements

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FIRST KEYSTONE CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2009 AND 2008
(Unaudited)

(Amounts in thousands)

	2009	2008
OPERATING ACTIVITIES		
Net income	$ 4,265	$ 3,608
Adjustments to reconcile net income to net cash used in operating activities:		
Provision or loan losses	450	125
Stock option expense	0	18
Provision for depreciation and amortization	339	464
Premium amortization on investment securities	106	61
Accretion of core deposit net discount	130	54
Discount accretion on investment securities	(541)	(326)
Gain on sale of mortgage loans	(96)	(42)
Proceeds from sale of mortgage loans	526	1,567
Originations of mortgage loans for resale	(13,869)	(7,662)
Gain on sales of investment securities	(133)	(123)
Deferred income tax (benefit)	(136)	(119)
Increase in interest receivable and other assets	(542)	(226)
Increase in cash surrender value of bank owned life insurance	(373)	(341)
Decrease in interest payable, accrued expenses and other liabilities	(199)	(205)
NET CASH USED IN OPERATING ACTIVITIES	$(10,073)	$ (3,147)
INVESTING ACTIVITIES		
Purchases of investment securities	$(51,594)	$(50,793)
Proceeds from sales of investment securities available for sale	33,886	26,191
Proceeds from Bank Owned Life Insurance	530	0
Proceeds from maturities and redemptions of investment securities		

available for sale	13,551	29,775
Proceeds from maturities and redemption of investment securities held to maturity	8	2,007
Net increase (decrease) in loans	12,277	(11,848)
Purchase of premises and equipment	(1,922)	(257)
Proceeds from sale of foreclosed assets	155	0
Decrease in other liabilities related to acquisition	0	(106)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	$ 6,891	$ (5,031)
FINANCING ACTIVITIES		
Net increase in deposits	$ 54,805	$ 29,758
Net decrease in short-term borrowings	(36,750)	(20,770)
Proceeds from long-term borrowings	0	10,000
Repayment of long-term borrowings	(25)	(5,023)
Proceeds from issuance of treasury stock under stock option plan	0	1
Cash dividends	(2,502)	(2,394)
NET CASH PROVIDED BY FINANCING ACTIVITIES	$ 15,528	$ 11,572
INCREASE IN CASH AND CASH EQUIVALENTS	$ 12,346	$ 3,394
CASH AND CASH EQUIVALENTS, BEGINNING	9,951	9,975
CASH AND CASH EQUIVALENTS, ENDING	$ 22,297	$ 13,369
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during period for		
Interest	$ 7,818	$ 9,570
Income Taxes	963	831

See Accompanying Notes to Consolidated Financial Statements

FIRST KEYSTONE CORPORATION AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2009
(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of First Keystone Corporation and Subsidiary (the "Corporation") are in accordance with accounting principles generally accepted in the United States of America and conform to common practices within the banking industry. The more significant policies follow:

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of First Keystone Corporation and its wholly owned Subsidiary, First Keystone National Bank (the "Bank"). All significant inter company balances and transactions have been eliminated in consolidation.

NATURE OF OPERATIONS

The Corporation, headquartered in Berwick, Pennsylvania, provides a full range of banking, trust and related services through its wholly-owned Bank subsidiary and is subject to competition from other financial institutions in connection with these services. The Bank serves a customer base which includes individuals, businesses, public and institutional customers primarily located in the Northeast Region of Pennsylvania. The Bank has 14 full service offices and 16 ATMs located in Columbia, Luzerne, Montour and Monroe Counties. The Corporation and its subsidiary must also adhere to certain federal banking laws and regulations and are subject to periodic examinations made by various federal agencies.

SEGMENT REPORTING

The Corporation's banking subsidiary acts as an independent community financial services provider, and offers traditional banking and related financial services to individual, business and government customers. Through its branch and automated teller machine network, the Bank offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer and mortgage loans; and the providing of other financial services. The Bank also performs personal, corporate, pension and fiduciary services through its Trust Department.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial, retail, trust and mortgage banking operations of the Corporation. Currently, management measures the performance and allocates the resources of First Keystone Corporation as a single segment.

USE OF ESTIMATES

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of these consolidated financial statements and the reported amounts of income and expenses during the reporting periods. Actual results could differ from those estimates.

INVESTMENT SECURITIES

The Corporation classifies its investment securities as either "Held to Maturity" or "Available for Sale" at the time of purchase. Debt securities are classified as Held to Maturity when the Corporation has the ability and positive intent to hold the securities to maturity. Investment securities Held to Maturity are carried at cost adjusted for amortization of premium and accretion of discount to maturity.

Debt securities not classified as Held to Maturity and equity securities are included in the Available for Sale category and are carried at fair value. The amount of any unrealized gain or loss, net of the effect of deferred income taxes, is reported as other comprehensive income (loss) in the Consolidated Statement of Changes in Stockholders' Equity.

Management's decision to sell Available for Sale securities is based on changes in economic conditions controlling the sources and applications of funds, terms, availability of and yield of alternative investments, interest rate risk and the need for liquidity.

The cost of debt securities classified as Held to Maturity or Available for Sale is adjusted for amortization of premiums and accretion of discounts to expected maturity. Such amortization and accretion, as well as interest and dividends is included in interest income from investments. Realized gains and losses are included in net investment securities gains and losses.

The cost of investment securities sold, redeemed or matured is based on the specific identification method.

LOANS

Loans are stated at their outstanding unpaid principal balances, net of deferred fees or costs, unearned income and the allowance for loan losses. Interest on installment loans is recognized as income over the term of each loan, generally, by the actuarial method. Interest on all other loans is primarily recognized based upon the principal amount outstanding on an actual day basis. Loan origination fees and certain direct loan origination costs have been deferred with the net amount amortized using the interest method over the contractual life of the related loans as an interest yield adjustment.

Mortgage loans held for resale are carried at the lower of cost or market on an aggregate basis. These loans are sold without recourse to the Corporation.

PAST-DUE LOANS - Generally, a loan is considered to be past due when scheduled loan payments are in arrears 15 days or more. Delinquent notices are generated automatically when a loan is 15 days past due, depending on the type of loan. Collection efforts continue on loans past due beyond 60 days that have not been satisfied, when it is believed that some chance exists for improvement in the status of the loan. Past due loans are continually evaluated with the determination for charge off being made when no reasonable chance remains that the status of the loan can be improved.

NON-ACCRUAL LOANS - Generally, a loan is classified as non accrual and the accrual of interest on such a loan is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan currently is performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on non accrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Certain non accrual loans may continue to perform, that is, payments are still being received. Generally, the payments are applied to principal. These loans remain under constant scrutiny and if performance continues, interest income may be recorded on a cash basis based on management's judgement as to collectibility of principal.

ALLOWANCE FOR LOAN LOSSES - The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible are charged against the allowance for loan losses and subsequent recoveries, if any, are credited to the allowance.

A principal factor in estimating the allowance for loan losses is the measurement of impaired loans. A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Under current accounting standards, the allowance for loan losses related to impaired loans is based on discounted cash flows using the effective interest rate of the loan or the fair value of the collateral for certain collateral dependent loans.

The allowance for loan losses is maintained at a level estimated by management to be adequate to absorb potential loan losses. Management's periodic evaluation of the adequacy of the allowance for loan losses is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change.

PREMISES AND EQUIPMENT

Premises, improvements and equipment are stated at cost less accumulated depreciation computed principally on the straight line method over the estimated useful lives of the assets. Long lived assets are reviewed for impairment whenever events or changes in business circumstances indicate that the carrying value may not be recovered. Maintenance and minor repairs are charged to operations as incurred. The cost and accumulated depreciation of the premises and equipment retired or sold are eliminated from the property accounts at the time of retirement or sale, and the resulting gain or loss is reflected in current operations.

MORTGAGE SERVICING RIGHTS

The Corporation originates and sells real estate loans to investors in the secondary mortgage market. After the sale, the Corporation may retain the right to service these loans. When originated mortgage loans are sold and servicing is retained, a servicing asset is capitalized based on relative fair value at the date of sale. Servicing assets are amortized as an offset to other fees in proportion to, and over the period of, estimated net servicing income. The unamortized cost is included in other assets in the accompanying consolidated balance sheet. The servicing rights are periodically evaluated for impairment based on their relative fair value.

FORECLOSED REAL ESTATE

Real estate properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value on the date of foreclosure establishing a new cost basis. 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 and is included in other assets. Revenues derived from and costs to maintain the assets and subsequent gains and losses on sales are included in other non interest income and expense. The total of foreclosed real estate properties included in other assets amounted to $0 and $28,000 at June 30, 2009 and December 31, 2008, respectively.

BANK OWNED LIFE INSURANCE

The Corporation invests in Bank Owned Life Insurance (BOLI) with split dollar life provisions. Purchase of BOLI provides life insurance coverage on certain employees with the Corporation being owner and beneficiary of the policies.

INVESTMENTS IN REAL ESTATE VENTURES

The Bank is a limited partner in real estate ventures that own and operate affordable residential low income housing apartment buildings for elderly residents. The investments are accounted for under the effective yield method under the Emerging Issues Task Force (EITF) 94-1, "Accounting for Tax Benefits Resulting from Investments in Affordable Housing Projects". Under the effective yield method, the Bank recognizes tax credits as they are allocated and amortizes the initial cost of the investment to provide a constant effective yield over the period that the tax credits are allocated to the Bank. Under this method, the tax credits allocated, net of any amortization of the investment in the limited partnerships, are recognized in the consolidated statements of income as a component of income tax expense. The amount of tax credits allocated to the Bank were $187,000 in 2008 and $151,000 in 2007, and the amortization of the investments in the limited partnerships were $77,000 and $74,000 for the six months ended June 30, 2009 and 2008, respectively. The carrying value of the investments as of June 30, 2009 and December 31, 2008 was $767,000 and $844,000, respectively, and is included in other assets in the accompanying consolidated balance sheets.

INCOME TAXES

The provision for income taxes is based on the results of operations, adjusted primarily for tax exempt income. Certain items of income and expense are reported in different periods for financial reporting and tax return purposes. Deferred tax assets and liabilities are determined based on the differences between the consolidated financial statement and income tax bases of assets and liabilities measured by using the enacted tax rates and laws expected to be in effect when the timing differences are expected to reverse. Deferred tax expense or benefit is based on the difference between deferred tax asset or liability from period to period.

GOODWILL, OTHER INTANGIBLE ASSETS, AND PREMIUM DISCOUNT

Goodwill resulted from the acquisition of the Pocono Community Bank in November 2007 (See Note 2) and of certain fixed and operating assets acquired and deposit liabilities assumed of the branch of another financial institution in Danville, Pennsylvania, in January 2004. Such goodwill represents the excess cost of the acquired assets relative to the assets fair value at the dates of acquisition. The Corporation accounts for goodwill pursuant to the Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Intangible Assets". During the first quarter of 2008, $152,000 of liabilities were recorded related to the Pocono acquisition as a purchase accounting adjustment resulting in an increase in the excess purchase price. The amount was comprised of the finalization of severance agreements and contract terminations related to the acquisition. SFAS No. 142 includes requirements to test goodwill for impairments rather than to amortize goodwill. The Corporation has tested the goodwill included in its consolidated balance sheet at December 31, 2008, and has determined there was no impairment as of that date.

Intangible assets are comprised of core deposit intangibles and premium discount (negative premium) on certificates of deposit acquired. The core deposit intangible is being amortized over the average life of the deposits acquired as determined by an independent third party. Premium discount (negative premium) on acquired certificates of deposit resulted from the valuation of certificate of deposit accounts by an independent third party. The book value of certificates of deposit acquired was greater than their fair value at the date of acquisition which resulted in a negative premium due to higher cost of the certificates of deposit compared to the cost of similar term financing.

STOCK BASED COMPENSATION

The Corporation sponsors a stock option plan (see Note 21). Prior to January 1, 2006 the Corporation had accounted for this Plan under the fair value recognition and measurement provisions of Statement of Financial Accounting Standards (SFAS) 123, "Accounting for Stock Based Compensation". Effective January 1, 2006 the Corporation adopted SFAS 123 (revised 2004), "Share Based Payment", using the modified prospective application method. Based on the terms of the Plan, the Corporation did not have a cumulative effect related to the Plan. Since the fair value recognition provisions of

SFAS 123 and SFAS 123R are essentially the same as they relate to the Corporation's Plan, the adoption of SFAS 123R did not and will not have a material impact on the Corporation's consolidated financial condition, results of operations or liquidity. The fair values of the stock awards are determined using the estimated expected life. The Corporation recognizes stock based compensation expense on the straight line basis over the period the stock award is earned by the employee.

PER SHARE DATA

Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings Per Share", requires dual presentation of basic and fully diluted earnings per share. Basic earnings per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding at the end of each period. Diluted earnings per share is calculated by increasing the denominator for the assumed conversion of all potentially dilutive securities. The Corporation's dilutive securities are limited to stock options. The most recent options issued were in December 2007.

CASH FLOW INFORMATION

For purposes of reporting consolidated cash flows, cash and cash equivalents include cash on hand and due from other banks and interest bearing deposits in other banks. The Corporation considers cash classified as interest bearing deposits with other banks as a cash equivalent since they are represented by cash accounts essentially on a demand basis.

TRUST ASSETS AND INCOME

Property held by the Corporation in a fiduciary or agency capacity for its customers is not included in the accompanying consolidated financial statements since such items are not assets of the Corporation. Trust Department income is generally recognized on a cash basis and is not materially different than if it were reported on an accrual basis.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2008, the FASB issued FASB Staff Position No. SFAS 140-4 and FIN 46(R)-8 (FSP 140-4), "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities". FSP 140-4 amends FASB Statement No. 140 to require public entities to provide additional disclosures about transfers of financial assets. It also amends FASB Interpretation No. 46 to require public enterprises, including sponsors that have a variable interest in a variable interest entity, to provide additional disclosures about their involvement with variable interest entities.

Additionally, this FSP requires certain disclosures to be provided by a public enterprise that is (a) a sponsor of a qualifying special purpose entity ("QSPE") that holds a variable interest in the QSPE but was not the transferor (non-transferor) of financial assets to the QSPE; and (b) a servicer of a QSPE that holds a significant interest in the QSPE but was not the transferor (non transferor) of financial assets to the QSPE. The Corporation does not have involvement with any variable interest entities.

In January 2009, the FASB ratified EITF 99-20-1, "Amendments to the Impairment Guidance of EITF Issue 99-20". EITF 99-20-1 amends the impairment guidance in EITF 99-20 to achieve more consistent determination of whether an other-than-temporary impairment has occurred. EITF 99-20-1 was effective December 31, 2008. The change in the impairment guidance with the issuance of FSP EITF 99-20-1 did not result in any material impact on the Corporation's consolidated financial condition, results if operation or liquidity.

In December 2007, the Financial Accounting Standards Board (FASB) issued State of Financial Accounting Standards SFAS 141(R), "Business Combinations". SFAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Corporation will account for business combinations under this Statement include: the acquisition date will be the date the acquirer obtains control; all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; acquisition related restructuring costs that do not meet the criteria in SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities", will be expensed as incurred; transaction costs will be expensed as incurred; reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. Additionally, SFAS 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition related contingencies, contingent consideration, noncontrolling interests, acquisition related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward.

The Corporation will be required to prospectively apply SFAS 141(R) to all business combinations completed on or after January 1, 2009. Early adoption is not permitted. For business combinations in which the acquisition date was before the effective date, the provisions of SFAS 141(R) will apply to the subsequent accounting for deferred income tax valuation allowances and income tax contingencies and will require any changes in those amounts to be recorded in earnings. The Corporation will adopt SFAS 141(R) for any business combinations occurring at or subsequent to January 1, 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards SFAS 160, "Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB 51". SFAS 160 establishes new accounting and reporting standards for noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 will require entities to classify noncontrolling interests as a component of stockholders' equity and will require subsequent changes in ownership interest in a subsidiary to be accounted for as an equity transaction. Additionally, SFAS 160 will require entities to recognize a gain or loss upon the loss of control of a subsidiary and to remeasure any ownership interest retained at fair value on that date. This statement also requires expanded disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective on a prospective basis for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, except for the presentation and disclosure requirements, which are required to be applied retrospectively. Early adoption is not permitted. The adoption of this standard is not expected to have a material impact on the Corporation's consolidated financial condition, results of operations or liquidity.

EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split Dollar Life Insurance Arrangements", was issued in September 2006 and is effective for fiscal years beginning after December 15, 2007 with earlier application permitted. EITF 06-4 requires that, for split dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods, an employer should recognize a liability for future benefits in accordance with SFAS No. 106. EITF 06-4 requires that recognition of the effects of adoption should be either by (a) a change in accounting principle through a cumulative effect adjustment to retained earnings as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. The Corporation adopted this standard as of January 1, 2007 through a cumulative effect adjustment to beginning retained earnings. This adjustment represented a decrease of $36,000 to retained earnings.

In June 2007, the FASB ratified the consensus reached in EITF 06-11, "Accounting for Income Tax Benefits of Dividends on Share Based Payment Awards". EITF 06-11 applies to entities that have share based payment arrangements that entitle employees to receive dividends or dividend equivalents on equity classified nonvested shares when those dividends or dividend equivalents are charged to retained earnings and result in an income tax deduction. Entities that have share based payment arrangements that fall within the scope of EITF 06-11 will be required to increase capital surplus for any realized income tax benefit associated with dividends or dividend equivalents paid to employees for equity classified nonvested equity awards. Any increase recorded to capital surplus is required to be included in any entity's pool of excess tax benefits that are available to absorb potential future tax deficiencies on share based payment awards. The Corporation adopted ITF 06-11 on January 1, 2008 for dividends declared on share based payment awards subsequent to this date. The impact of adoption did not have any material impact on the Corporation's consolidated financial condition, results of operations, or liquidity.

In April 2007, the FASB issued FSP 39-1, "Amendments of FASB Interpretation No. 39. Offsetting of Amounts Related to Certain

Contracts". FSP 39-1 permits entities to offset fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting agreement. FSP 39-1 clarifies that the fair value amounts recognized for the right to reclaim cash collateral, or the obligation to return cash collateral, arising from the same master netting arrangement, should also be offset against the fair value of the related derivative instruments.

Effective January 1, 2008, the Corporation adopted a net presentation for derivative positions and related collateral entered into under master netting agreements pursuant to the guidance in FIN 39 and FSP 39-1. The adoption of this guidance would result in balance sheet reclassifications of certain cash collateral based short term investments against the related derivative liabilities and certain deposit liability balances against the related fair values of derivative assets. The effects of these reclassifications will fluctuate based on the fair values of derivative contracts but overall would not have a material impact on either total assets or total liabilities. The adoption of these standards did not have an impact on the Corporation's consolidated financial condition, results of operations or liquidity.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities". The statement allows an entity to elect to measure certain financial assets and liabilities at fair value with changes in fair value recognized in the income statement each period. The statement also requires additional disclosures to identify the effects of an entity's fair value election on its earnings. The election is irrevocable. The Corporation has chosen not to elect to measure any specific group of financial assets or liabilities pursuant to SFAS 159.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards SFAS 158 "Employers' Accounting for Defined Benefit Pension and Other Post Retirement Plans", which requires the Corporation to recognize the funded status of a benefit plan as either assets or liabilities in the consolidated balance sheet and to recognize as a component of other comprehensive income, net of tax, unrecognized actuarial gains or losses, prior service costs and transition obligations that arise during the period. The adoption of SFAS 158 for year ended December 31, 2007 did not have a material impact on the Corporation's consolidated financial position, results of operations, or liquidity.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) 157, "Fair Value Measurements", which upon adoption will replace various definitions of fair value in existing accounting literature with a single definition, will establish a framework for measuring fair value, and will require additional disclosures about fair value measurements. The statement clarifies that fair value is the price that would be received to sell an asset or the price paid to transfer a liability in the most advantageous market available to the entity and emphasizes that fair value is a market based measurement and should be based on the assumptions market participants would use. The statement also creates a three level hierarchy under which individual fair value estimates are to be ranked based on the relative reliability of the inputs used in the valuation. This hierarchy is the basis for the disclosure requirements, with fair value estimates based on the least reliable inputs requiring more extensive disclosures about the valuation method used and the gains and losses associated with those estimates. SFAS 157 is required to be applied whenever another financial accounting standard requires or permits an asset or liability to be measured at fair value. The statement does not expand the use of fair value to any new circumstances. The Corporation has applied the new guidance beginning January 1, 2008, and such application did not have a material impact on the Corporation's consolidated financial condition, results of operations, or liquidity.

In July 2006, the FASB issued FASB Staff Position FSP 13-2, "Accounting for a Change or Projected Change in the Timing of Cash Flows Related to Income Taxes Generated by a Leveraged Lease Transaction". This FSP amends SFAS 13, "Accounting for Leases", to require a lessor in a leveraged lease transaction to recalculate the leveraged lease for the effects of a change or projected change in the timing of cash flows relating to income taxes that are generated by the leveraged lease. The guidance in FSP 13-2 was adopted by the Corporation on January 1, 2007. The application of this FSP did not have a material impact on the Corporation's consolidated financial condition, results of operations, or liquidity.

In June 2006, the FASB issued Interpretation No. 48 FIN 48, "Accounting for Uncertainty in Income Taxes", an interpretation of SFAS 109, "Accounting for Income Taxes". FIN 48 prescribes a comprehensive model for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions shall initially be recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements to include an annual tabular roll forward of unrecognized tax benefits. The provisions of this interpretation were adopted by the Corporation on January 1, 2007. The adoption of FIN 48 did not have a material impact on the Corporation's consolidated financial condition, result of operations, or liquidity.

In March 2006, the FASB issued Statement of Financial Accounting Standards SFAS 156, "Accounting for Servicing of Financial Assets", an amendment of SFAS 140. This standard requires entities to separately recognize a servicing asset or liability whenever it undertakes an obligation to service financial assets and also requires all separately recognized servicing assets or liabilities to be initially measured at fair value. Additionally, this standard permits entities to choose among two alternatives, the amortization method or fair value measurement method, for the subsequent measurement of each class of separately recognized servicing assets and liabilities. Under the amortization method, an entity shall amortize the value of servicing assets or liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and assess servicing assets or liabilities for impairment or increased obligation based on fair value at each reporting date. Under the fair value measurement method, an entity shall measure servicing assets or liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur.

Effective January 1, 2006, the Corporation adopted this statement by electing amortization method as the measurement method for residential real estate mortgage servicing rights (MSRs).

In February 2006, the FASB issued Statement of Financial Accounting Standards SFAS 155, "Accounting for Certain Hybrid Financial Instruments", which amends SFAS 133, "Accounting for Derivative Instruments and Hedging Activities", and SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". SFAS 155 requires entities to evaluate and identify whether interests in securitized financial assets are freestanding derivatives, hybrid financial instruments that contain an embedded derivative requiring bifurcation, or hybrid financial instruments that contain embedded derivatives that do not require bifurcation. SFAS 155 also permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. This statement was effective for all financial instruments acquired or issued by the Corporation on or after January 1, 2007 and the adoption of SFAS 155 did not have a material impact on the Corporation's consolidated financial condition, results of operations or liquidity.

Advertising Costs

It is the Corporation's policy to expense advertising costs in the period in which they are incurred. Advertising expense for the six months ended June 30, 2009 and 2008 was approximately $115,000 and $156,000, respectively.

RECLASSIFICATIONS

Certain amounts in the consolidated financial statements of prior periods have been reclassified to conform with presentation used in the 2009 consolidated financial statements. Such reclassifications have no effect on the Corporation's consolidated financial condition or net income.

NOTE 2. ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses for the periods ended June 30, 2009 and June 30, 2008 were as follows:

(amounts in thousands)

	June 30, 2009	June 30, 2008
Balance, January 1	$5,195	$5,047
Provision charged to operations	450	125
Loans charged off	(431)	(68)
Recoveries	11	71
Balance, June 30	$5,225	$5,175

At June 30, 2009, the recorded investment in loans that are considered to be impaired as defined by SFAS No. 114 was $2,532,000. No additional charge to operations was required to provide for the impaired loans since the total allowance for loan losses is estimated by management to be adequate to provide for the loan loss allowance required by SFAS No. 114 along with any other potential losses.

At June 30, 2009 there were no significant commitments to lend additional funds with respect to non accrual and restructured loans.

Non-accrual loans at June 30, 2009 and December 31, 2008 were $2,532,000 and $1,718,000, respectively.

Loans past-due 90 days or more and still accruing interest amounted to $0 and $15,000 on June 30, 2009 and December 31, 2008, respectively.

NOTE 3. SHORT-TERM BORROWINGS

Federal funds purchased, securities sold under agreements to repurchase and Federal Home Loan Bank advances generally represent overnight or less than 30 day borrowings. U.S. Treasury tax and loan notes for collections made by the Bank are payable on demand.

NOTE 4. LONG-TERM BORROWINGS

Long-term borrowings are comprised of advances from the Federal Home Loan Bank (FHLB). Under terms of a blanket agreement, collateral for the loans are secured by certain qualifying assets of the Corporation's banking subsidiary which consist principally of first mortgage loans and certain investment securities.

NOTE 5. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

The Corporation 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 or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments. The Corporation does not engage in trading activities with respect to any of its financial instruments with off balance sheet risk.

The Corporation'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 notional amount of those instruments.

The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments.

The Corporation may require collateral or other security to support financial instruments with off balance sheet credit risk. The contract or notional amounts at June 30, 2009, and December 31, 2008, were as follows:

(amounts in thousands)

	June 30, 2009	December 31, 2008
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$43,820	$52,762
Financial standby letters of credit	843	904
Performance standby letters of credit	6,422	6,936

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 that may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counter party. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income producing commercial properties.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation may hold collateral to support standby letters of credit for which collateral is deemed necessary.

The Corporation grants commercial, agricultural, real estate mortgage and consumer loans to customers primarily in the counties of Columbia, Luzerne, Montour, and Monroe, Pennsylvania. It is management's opinion that the loan portfolio was well balanced and diversified at June 30, 2009, to the extent necessary to avoid any significant concentration of credit risk. However, its debtors' ability to honor their contracts may be influenced by the region's economy.

NOTE 6. STOCKHOLDERS' EQUITY

Changes in Stockholders' Equity for the period ended June 30, 2009 were are follows:

(Amounts in thousands, except common share data)

	Common Shares	Common Stock	Surplus
Balance at January 1, 2009	5,687,767	$11,375	$30,269
Comprehensive Income:			
Net Income			
Change in unrealized gain (loss) on investment securities available-for-sale, net of reclassification adjustment and tax effects			
Total Comprehensive income (loss)			
Cash dividends - $.46 per share			
Balance at June 30, 2009	5,687,767	$11,375	$30,269

(Amounts in thousands, except common share data)

	Compre-	Accumulated Other

	hensive Income	Retained Earnings	Comprehensive Income (Loss)
Balance at January 1, 2009		$38,414	$(4,671)
Comprehensive Income:			
Net Income	$4,265	4,265	
Change in unrealized gain (loss) on investment securities available-for-sale, net of reclassification adjustment and tax effects	260		260
Total Comprehensive income (loss)	$4,525		
Cash dividends - $.23 per share		(2,502)	
Balance at June 30, 2009		$40,177	$(4,411)

(Amounts in thousands, except common share data)

	Treasury Stock	Total
Balance at January 1, 2009	$(6,240)	$69,147
Comprehensive Income:		
Net Income		4,265
Change in unrealized gain (loss) on investment securities available-for-sale, net of reclassification adjustment and tax effects		260
Total Comprehensive income (loss)		
Cash dividends - $.23 per share		(2,502)
Balance at June 30, 2009	$(6,240)	$71,170

NOTE 7. MANAGEMENT'S ASSERTIONS AND COMMENTS REQUIRED TO BE PROVIDED WITH FORM 10Q FILING

In management's opinion, the consolidated interim financial statements reflect fair presentation of the consolidated financial position of First Keystone Corporation and Subsidiary, and the results of their operations and their cash flows for the interim periods presented. Further, the consolidated interim financial statements are unaudited; however they reflect all adjustments, which are in the opinion of management, necessary to present fairly the consolidated financial condition and consolidated results of operations and cash flows for the interim periods presented and that all such adjustments to the consolidated financial statements are of a normal recurring nature. The independent registered public accounting firm, J. H. Williams & Co., LLP, reviewed these consolidated financial statements as stated in their accompanying review report.

The results of operations for the six month period ended June 30, 2009, are not necessarily indicative of the results to be expected for the full year.

These consolidated interim financial statements have been prepared in accordance with requirements of Form 10Q and therefore do not include all disclosures normally required by accounting principles generally accepted in the United States of America applicable to financial institutions as included with consolidated financial statements included in the Corporation's annual Form 10K filing. The reader of these consolidated interim financial statements may wish to refer to the Corporation's annual report or Form 10K for the period ended December 31, 2008, filed with the Securities and Exchange Commission.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders of First Keystone Corporation:

We have reviewed the accompanying consolidated balance sheet of First Keystone Corporation and Subsidiary as of June 30, 2009, and the related consolidated statements of income for the three and six month periods ended June 30, 2009 and 2008 and cash flows for the six month periods ended June 30, 2009, and 2008. These consolidated interim financial statements are the responsibility of the management of First Keystone Corporation and Subsidiary.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated interim financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of First Keystone Corporation and Subsidiary as of December 31, 2008, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 9, 2009, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2008, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ J. H. Williams & Co., LLP
J. H. Williams & Co., LLP

Kingston, Pennsylvania
August 7, 2009

ITEM 2. First Keystone Corporation Management's Discussion and Analysis of Financial Condition and Results of Operation as of June 30, 2009

This quarterly report contains certain forward looking statements (as defined in the Private Securities Litigation Reform Act of 1995), which reflect management's beliefs and expectations based on information currently available. These forward-looking statements are inherently subject to significant risks and uncertainties, including changes in general economic and financial market conditions, the Corporation's ability to effectively carry out its business plans and changes in regulatory or legislative requirements. Other factors that could cause or contribute to such differences are changes in competitive conditions, and pending or threatened litigation. Although management believes the expectations reflected in such forward looking statements are reasonable, actual results may differ materially.

RESULTS OF OPERATIONS

First Keystone Corporation realized earnings for the second quarter of 2009 of $2,163,000, an increase of $277,000, or 14.7% from the second quarter of 2008. Six months net income for the period ended June 30, 2009 amounted to $4,265,000, an increase of $657,000, or 18.2% from the $3,608,000 net income reported June 30, 2008. Net interest income increased in both the second quarter of 2009 and for the six months ending June 30, 2009, when compared to the same periods in 2008. Our net interest margin did increase to 3.56% for the second quarter of 2009, up from 3.28% in the second quarter of 2008. Our net interest margin for the six months ended June 30, 2009 was 3.59%. The net interest margin and net interest income increases are primarily a result of a steepened yield curve and reduced interest rates on deposits and liabilities. Also, an increase in non interest income before investment securities gains in the second quarter and for the six months ended June 30, 2009, helped increase earnings. On a per share basis, net income per share increased to $.78 for the first six months of 2009 compared to $.66 for the first six months of 2008, while dividends were at $.46 per share as compared to $44 at the end of the first two quarters in 2008.

Year-to-date net income annualized amounts to a return on average common equity of 12.08% and a return on assets of 1.16%. For the six months ended June 30, 2008, these measures were 10.35% and 1.05%, respectively on an annualized basis.

NET INTEREST INCOME

The major source of operating income for the Corporation is net interest income, defined as interest income less interest expense. In the second quarter of 2009, interest income amounted to $9,406,000, an increase of $139,000 or 1.5% from the second quarter of 2008. Interest expense amounted to $3,950,000 in the second quarter of 2009, a decrease of $596,000, or 13.1% from the second quarter of 2008. As a result, net interest income amounted to $5,456,000 in the second quarter of 2009, an increase of $735,000, or 15.6% from the second quarter of 2008. Year to date for the six months ended June 30, 2009, net interest income increased $1,565,000, or 17.0% to $10,784,000 from $9,219,000 in 2008.

PROVISION FOR LOAN LOSSES

The provision for loan losses for the quarter ended June 30, 2009, was $175,000, an increase of $100,000 from the second quarter of 2008. Year to date, the provision for loan losses amounts to $450,000 in 2009, an increase of $325,000 from June 30, 2008. The increased provision for loan losses was a result of increased net charge offs. Net charge offs amounted to $420,000 for the six months ended June 30, 2009, as compared to $(3,000) for the first six months of 2008.

The allowance for loan losses as a percentage of loans, net of unearned interest remains strong at 1.28% as of June 30, 2009, as compared to 1.27% as of December 31, 2008.

NON-INTEREST INCOME

Total non interest or other income was $1,310,000 for the quarter ended June 30, 2009, as compared to $998,000 for the quarter ended June 30, 2008. Excluding investment securities gains and losses, non interest income was $1,303,000 for the second quarter of 2009, as compared to $979,000 in the second quarter of 2008, an increase of 33.1%. For the six months ended June 30, 2009, total non interest income was $2,346,000, an increase of $243,000, or 11.6 from the first six months of 2008. Excluding investment securities gains, non interest income for the six months ended June 30, 2009, was $2,213,000, an increase of 11.8% from the $1,980,000 reported for the first six months of 2008.

NON-INTEREST EXPENSES

Total non interest or other expenses was $4,160,000 for the quarter ended June 30, 2009, as compared to $3,348,000 for the quarter ended June 30, 2008. Our FDIC insurance increased to $593,000 in the second quarter of 2009, up from $25,000 in the second quarter of 2008. In addition, salaries and employee. benefits, occupancy, and furniture and equipment expense increased during the second quarter of 2009.

For the six months ended June 30, 2009, total non interest expense was $7,676,000, an increase of $878,000, or 12.9% over the first six months of 2008. Expenses associated with employees (salaries and employee benefits) continue to be the largest category of non interest expenses. Salaries and benefits amount to 50.4% of total non interest expense for the six months ended June 30, 2009, as compared to 53.7% for the first six months of 2008. Salaries and benefits amounted to $3,867,000 for the six months ended June 30, 2009, an increase of $214,000, or 5.9% from the first six months of 2008. Net occupancy expense, including furniture and equipment, amounted to $1,114,000 for the six months ended June 30, 2009, an increase of $133,000, or 13.6% from 2008. Expenses for professional services decreased $25,000 or 12.8% from the first six months of 2008. State shares tax increased by $6,000 or 1.8% over the first six months of 2008. FDIC insurance was $775,000, a substantial increase over the $53,000 in FDIC insurance as of June 30, 2008. The increase reflects higher premium payments plus a special one time assessment levied by the FDIC on all banks. Other non interest expenses amounted to $1,403,000 for the six months ended June 30, 2009, a decrease of $172,000, or 10.9% from the first six months of 2008. Even with the increase in non interest expenses in 2009, our overall non interest expense continues at approximately 2.0% of average assets on an annualized basis. This places us among the leaders of our peer financial institutions at controlling non interest expense.

INCOME TAXES

Effective tax planning has helped produce favorable net income. The effective total income tax rate was 11.0% for the second quarter of 2009 as compared to 17.9% for the second quarter of 2008. For the six months ended June 30, 2009, our tax expense amounted to $739,000 for an effective tax rate of 14.8% as compared to an effective tax rate of 18.0% for the first six months of 2008.

ANALYSIS OF FINANCIAL CONDITION

ASSETS

Total assets increased to $734,967,000 as of June 30, 2009, an increase of $20,069,000, or 2.8% over year end 2008. Total deposits increased to $559,428,000 as of June 30, 2009, an increase of $54,795,000, or 10.9% over year end 2008.

The Corporation decreased short term borrowings by $36,750,000, or 66.4% as of June 30, 2009, when compared to year end 2008. Also, long term borrowings decreased slightly by $42,000 to $82,020,000 from year end 2008.

EARNING ASSETS

Our primary earning asset, loans, net of unearned income increased to $409,019,000 as of June 30, 2009, a slight increase of $652,000 from $408,367,000, or 0.2% since year end 2008. The loan portfolio continues to be well diversified. Asset quality has declined with both net charge offs and non performing assets increasing since year end 2008.

In addition to loans, another primary earning asset is our investment portfolio which increased in size from December 31, 2008, to June 30, 2009. Available for sale securities amounted to $243,261,000 as of June 30, 2009, a increase of $3,086,000, or 1.3% from year end 2008. Held to maturity securities increased to $4,982,000 as of June 30, 2009, an increase of $1,992,000, or 66.6% from year end 2008.

ALLOWANCE FOR LOAN LOSSES

Management performs a quarterly analysis to determine the adequacy of the allowance for loan losses. The methodology in determining adequacy incorporates specific and general allocations together with a risk/loss analysis on various segments of the portfolio according to an internal loan review process. Management maintains its loan review and loan classification standards consistent with those of its regulatory supervisory authority. Management feels, considering the conservative portfolio composition, which is largely composed of small retail loans (mortgages and installments) with minimal classified assets, low delinquencies, and favorable loss history, that the allowance for loan loss is adequate to cover foreseeable future losses.

Any loans classified for regulatory purposes as loss, doubtful, substandard, or special mention that have not been disclosed under Industry Guide 3 do not (i) represent or result from trends or uncertainties which management reasonably expects will materially impact future operating results, liquidity, or capital resources, or (ii) represent material credits about which management is aware of any information which causes management to have serious doubts as to the ability of such borrowers to comply with the loan repayment terms.

The company was required to adopt Financial Accounting Standards Board Statement No. 114, "Accounting by Creditors for Impairment of a Loan" - Refer to Note 2 above for details.

NON-PERFORMING ASSETS

Non performing assets consist of non accrual and restructured loans, other real estate and foreclosed assets, together with the loans past due 90 days or more and still accruing. As of June 30, 2009, total non performing assets were $2,532,000 as compared to $1,761,000 on December 31, 2008. Non performing assets to total loans and foreclosed assets was .62% as of June 30, 2009, and .43% as of December 31, 2008.

Interest income received on non performing loans as of June 30, 2009, was $15,000 compared to $95,000 as of December 31, 2008. Interest income, which would have been recorded on these loans under the original terms as of June 30, 2009, and December 31, 2008 was $94,000 and $149,000, respectively. As of June 30, 2009 and December 31, 2008, there were no outstanding commitments to advance additional funds with respect to these non-performing loans.

DEPOSITS AND OTHER BORROWED FUNDS

As indicated previously, total deposits increased by $54,795,000 as non interest bearing deposits increased by $603,000 and interest bearing deposits increased by $54,192,000 as of June 30, 2009, from year end 2008. Total short term and long term borrowings decreased to $36,792,000 as of June 30, 2009 to $100,602,000, as compared to $137,394,000 in total borrowings as of year end 2008.

CAPITAL STRENGTH

Normal increases in capital are generated by net income, less cash dividends paid out. Also, accumulated other comprehensive income derived from unrealized gains or losses on investment securities available for sale decreased shareholders' equity, or capital, net of taxes, by $4,441,000 as of June 30, 2009, and decreased capital by $4,671,000 as of December 31, 2008. Treasury stock had an effect of reducing our total stockholders' equity by $6,240,000 on June 30, 2009, and December 31, 2008.

Total stockholders' equity was $71,170,000 as of June 30, 2009, and $69,147,000 as of December 31, 2008. Leverage ratio and risk based capital ratios remain very strong. As of June 30, 2009, our leverage ratio was 7.47% compared to 7.59% as of December 31, 2008. In addition, Tier I risk based capital and total risk based capital ratio as of June 30, 2009, were 10.88% and 11.93%, respectively. The same ratios as of December 31, 2008, were 10.95% and 12.02%, respectively.

LIQUIDITY

The liquidity position of the Corporation remains adequate to meet customer loan demand and deposit fluctuation. Managing liquidity remains an important segment of asset liability management. Our overall liquidity position is maintained by an active asset liability management committee.

Management feels its current liquidity position is satisfactory, given a very stable core deposit base which has generally increased annually. Secondly, our loan payments and principal paydowns on our mortgage backed securities provide a steady source of funds. Also, short term investments and maturing investment securities represent additional sources of liquidity. Finally, short term borrowings are readily accessible at the Federal Reserve Bank discount window, Atlantic Central Bankers Bank, or the Federal Home Loan Bank.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the Company's quantitative and qualitative market risks since December 31, 2008. The composition of rate sensitive assets and rate sensitive liabilities as of June 30, 2009 is very similar to December 31, 2008.

ITEM 4. Controls and Procedures

a) Evaluation of disclosure controls and procedures. The company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures performed within 90 days of the filing date of this report, the chief executive and chief financial officers of the company concluded that the company's disclosure controls and procedures were adequate.

b) Changes in internal controls. The Company made no significant changes in its internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation of the controls by the Chief Executive and Chief Financial officers.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. There have been no material changes in our "Risk Factors" as previously disclosed in our Annual Report on Form 10K for the year ended December 31, 2008.

Item 2. Changes in Securities, Use of Proceeds and 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
April 1 - April 30, 2009	----	----	----	112,098
May 1 - May 31, 2009	----	----	----	112,098
June 1 - June 30, 2009	----	----	----	112,098
Total	----	----	----	112,098

Item 3. Defaults Upon Senior Securities

None.

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

Annual Meeting of Shareholders of First Keystone Corporation held on Tuesday, May 5, 2009 at 10:00 a.m.

Directors Elected	Votes For	Votes Against	Votes Withheld
Jerome F. Fabian	4,379,282	27,419	0
John G. Gerlach	4,206,948	199,753	0

David R. Saracino	4,206,740	199,961	0

Directors Elected	Abstentions	Broker Non-Votes
Jerome F. Fabian	0	0
John G. Gerlach	0	0
David R. Saracino	0	0

Directors Continuing:

John E. Arndt, term expires in 2010
J. Gerald Bazewicz, term expires in 2010
Robert E. Bull, term expires in 2010
Joseph B. Conahan, Jr., term expires in 2010
Don E. Bower, term expires in 2011
Robert A. Bull, term expires in 2011

Matters Voted Upon:

Selection of J. H. Williams & Co. LLP, as auditors for the Corporation.

Votes For - 4,399,923
Votes Against - 2,862
Votes Withheld - 0
Abstentions - 3,916
Broker Non-Votes - 0

Item 5. Other Information

The Company made no material changes to the procedures by which shareholders may recommend nominees to the Company's Board of Directors.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits required by Item 601 Regulation S-K

Exhibit Number	Description of Exhibit
3i	Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3(i) to the Registrant's Report on Form 10Q for the quarter ended March 31, 2006).
3ii	By-Laws, as amended (Incorporated by reference to Exhibit 3(ii) to the Registrant's Report on Form 10Q for the quarter ended March 31, 2006).
10.1	Supplemental Employee Retirement Plan (Incorporated by reference to Exhibit 10 to the Registrant's Report on Form 10Q for the quarter ended September 30, 2005).
10.2	Management Incentive Compensation Plan (Incorporated by reference to Exhibit 10 to the Registrant's Report on Form 10Q for the quarter ended September 30, 2006).
10.3	Profit Sharing Plan (Incorporated by reference to Exhibit 10 to the Registrant's Report on Form 10Q for the quarter ended September 30, 2006).
10.4	First Keystone Corporation 1998 Stock Incentive Plan (Incorporated by reference to Exhibit 10 to the Registrant's Report on Form 10Q for the quarter ended September 30, 2006).
14	Code of Ethics (Incorporated by reference to Exhibit 14 to the Registrant's Report on Form 8K dated January 9, 2007).
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Chief Financial Officer.

FIRST KEYSTONE CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of

1934, the Registrant has duly cause this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST KEYSTONE CORPORATION
Registrant

August 7, 2009	/s/ J. Gerald Bazewicz J. Gerald Bazewicz President and Chief Executive Officer (Principal Executive Officer)
August 7, 2009	/s/ Diane C.A. Rosler Diane C.A. Rosler Chief Financial Officer (Principal Accounting Officer)

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INDEX TO EXHIBITS

Exhibit	Description
3i	Articles of Incorporation, as amended (Incorporated by reference to Exhibit 3(i) to the Registrant's Report on Form 10Q for the quarter ended March 31, 2006).
3ii	By-Laws, as amended (Incorporated by reference to Exhibit 3(ii) to the Registrant's Report on Form 10Q for the quarter ended March 31, 2006).
10.1	Supplemental Employee Retirement Plan (Incorporated by reference to Exhibit 10 to the Registrant's Report on Form 10Q for the quarter ended September 30, 2005).
10.2	Management Incentive Compensation Plan (Incorporated by reference to Exhibit 10 to the Registrant's Report on Form 10Q for the quarter ended September 30, 2006).
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