

SOUTHSIDE BANCSHARES INC
Form 10-Q/A
April 30, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A
Amendment No. 1

(Mark One)

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from _____ to _____

Commission file number 0-12247

SOUTHSIDE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

TEXAS
(State or other jurisdiction of
incorporation or organization)

75-1848732
(I.R.S. Employer
Identification No.)

1201 S. Beckham, Tyler, Texas
(Address of principal executive offices)

75701
(Zip Code)

903-531-7111
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

to submit and post such files). Yes 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of shares of the issuer's common stock, par value \$1.25, outstanding as of October 31, 2011 was 16,465,690 shares.

Explanatory Note

This Amendment No. 1 on Form 10-Q/A amends the Quarterly Report on Form 10-Q for the period ended September 30, 2011, which was originally filed with the Securities and Exchange Commission (the “SEC”) on November 8, 2011 (the “Original Filing”). This amendment is being filed to reflect the restatement of i) the quarterly results of Southside Bancshares, Inc. (the “Company”), as discussed in Note 2 to the unaudited consolidated financial statements contained herein, and ii) other information related to such restated financial information. Except for Items 1, 2 and 4 of Part I and Item 6 of Part II, no other information included in the Original Filing is amended by this Form 10-Q/A.

During the preparation of the Form 10-K for the year ended December 31, 2011 (the “2011 Form 10-K”), the Company determined that in periods prior to December 31, 2011, it incorrectly accounted for securities acquired with a significant purchase premium that included an embedded derivative. These securities were mainly acquired in 2010 and 2011. Pursuant to GAAP, the Company is required to bifurcate and account for the embedded derivative separately or to account for the securities including the embedded derivative at fair value through income, if the bifurcation was impractical. The Company determined that valuing the embedded derivative separately was not readily identifiable and measurable and as such, cannot be bifurcated. Therefore, the Company determined that all securities meeting the above criteria should be reflected at fair value with the change in fair value reflected through income.

In addition, the Company determined that during the first three quarters of 2011, it incorrectly priced securities acquired with a significant premium and did not account for the impairment of FHLB advance option fees that became impaired during the third quarter of 2011.

The Company evaluated the effect of these three errors and concluded that they were immaterial to any of the previously issued consolidated financial statements except for the unaudited consolidated financial statements included in the Company’s Quarterly Reports on Form 10-Q for the periods ended March 31, June 30, and September 30, 2011. Accordingly, on March 8, 2012, the Company filed a Form 8-K reporting that the Audit Committee of the Board of Directors of the Company determined based on the recommendation of management, that the Company should restate its unaudited consolidated financial statements in each of these Quarterly Reports on Form 10-Q. In addition, the Company revised its 2010 consolidated financial statements in the 2011 Form 10-K to correct for these errors.

See Note 2 – Restatement to Previously Issued Financial Statements contained in the Notes to Financial Statements included in this Form 10-Q/A which further describes the effect of this restatement.

Pursuant to Rule 12b-15 of the Securities Exchange Act of 1934, as amended, this Form 10-Q/A includes new certifications by our principal executive officer and principal financial officer under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. Except for the items noted above, no other information included in the Original Filing is being amended by this Form 10-Q/A. This Form 10-Q/A continues to speak as of the date of the Original Filing and we have not updated the filing to reflect events occurring subsequent to the date of the Original Filing other than those associated with the restatement of the Company’s financial statements. Accordingly, this Form 10-Q/A should be read in conjunction with the Company’s filings with the SEC subsequent to the Original Filing, including any amendments to those filings.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands, except share amounts)

ASSETS	September 30, 2011 (Restated)	December 31, 2010
Cash and due from banks	\$ 42,527	\$ 56,188
Interest earning deposits	4,604	22,885
Total cash and cash equivalents	47,131	79,073
Investment securities:		
Available for sale, at estimated fair value	304,994	299,344
Held to maturity, at amortized cost	1,496	1,495
Mortgage-backed and related securities:		
Available for sale, at estimated fair value	715,192	886,574
Securities carried at fair value through income	567,639	72,176
Held to maturity, at amortized cost	379,336	405,367
FHLB stock, at cost	29,057	34,712
Other investments, at cost	2,064	2,064
Loans held for sale	5,491	6,583
Loans:		
Loans	1,040,471	1,077,920
Less: allowance for loan losses	(18,189)	(20,711)
Net Loans	1,022,282	1,057,209
Premises and equipment, net	50,481	50,144
Goodwill	22,034	22,034
Other intangible assets, net	580	777
Interest receivable	15,957	18,033
Deferred tax asset	-	6,603
Other assets	48,186	57,571
TOTAL ASSETS	\$ 3,211,920	\$ 2,999,759
LIABILITIES AND EQUITY		
Deposits:		
Noninterest bearing	\$ 477,128	\$ 423,304
Interest bearing	1,816,632	1,711,124
Total Deposits	2,293,760	2,134,428
Short-term obligations:		
Federal funds purchased and repurchase agreements	2,997	3,844
FHLB advances	287,204	189,094
Other obligations	2,226	2,651
Total Short-term obligations	292,427	195,589
Long-term obligations:		
FHLB advances	275,458	373,479

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Long-term debt	60,311	60,311
Total Long-term obligations	335,769	433,790
Deferred tax liability	7,604	–
Other liabilities	23,150	20,378
TOTAL LIABILITIES	2,952,710	2,784,185

Off-Balance-Sheet Arrangements, Commitments and Contingencies (Note 11)

Shareholders' equity:

Common stock - \$1.25 par, 40,000,000 shares authorized, 18,489,528 shares issued in 2011 and 17,660,312 shares issued in 2010	23,112	22,075
Paid-in capital	176,086	162,877
Retained earnings	69,340	64,179
Treasury stock (2,023,838 shares at cost)	(28,377)	(28,377)
Accumulated other comprehensive income (loss)	19,049	(6,293)
TOTAL SHAREHOLDERS' EQUITY	259,210	214,461
Noncontrolling interest	–	1,113
TOTAL EQUITY	259,210	215,574
TOTAL LIABILITIES AND EQUITY	\$ 3,211,920	\$ 2,999,759

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

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CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(in thousands, except per share data)

	Three Months		Nine Months	
	Ended September 30, 2011 (Restated)	2010	Ended September 30, 2011 (Restated)	2010
Interest income				
Loans	\$ 16,229	\$ 16,926	\$ 50,630	\$ 52,128
Investment securities – taxable	11	20	49	72
Investment securities – tax-exempt	3,069	2,366	9,507	8,209
Mortgage-backed and related securities	13,292	13,378	37,899	37,937
FHLB stock and other investments	50	59	182	200
Other interest earning assets	2	4	15	19
Total interest income	32,653	32,753	98,282	98,565
Interest expense				
Deposits	3,879	4,874	11,966	14,612
Short-term obligations	1,643	2,086	5,077	5,633
Long-term obligations	3,115	4,504	10,397	14,585
Total interest expense	8,637	11,464	27,440	34,830
Net interest income	24,016	21,289	70,842	63,735
Provision for loan losses	1,454	3,201	5,452	9,328
Net interest income after provision for loan losses	22,562	18,088	65,390	54,407
Noninterest income				
Deposit services	4,098	4,280	12,005	12,744
Gain on sale of securities available for sale	3,609	8,008	9,080	23,024
Gain on sale of securities carried at fair value through income	254	–	592	–
Total other-than-temporary impairment losses	–	–	–	(39)
Portion of loss recognized in other comprehensive income (before taxes)	–	–	–	(36)
Net impairment losses recognized in earnings	–	–	–	(75)
Fair value gain (loss) – securities	3,274	–	7,357	–
FHLB advance option impairment charges	(7,819)	–	(7,819)	–
Gain on sale of loans	402	517	967	1,197
Trust income	672	645	1,968	1,736
Bank owned life insurance income	288	297	835	867
Other	957	931	3,021	2,728
Total noninterest income	5,735	14,678	28,006	42,221
Noninterest expense				
Salaries and employee benefits	11,280	10,891	34,593	33,048
Occupancy expense	1,866	1,720	5,365	5,025
Equipment expense	540	532	1,558	1,441
Advertising, travel & entertainment	591	616	1,694	1,697
ATM and debit card expense	235	223	716	602
Director fees	193	197	584	590
Supplies	186	189	571	665
Professional fees	571	418	1,583	1,363

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Postage	178	195	543	612
Telephone and communications	285	349	967	1,068
FDIC Insurance	212	804	1,710	2,172
Other	1,559	1,521	4,660	4,803
Total noninterest expense	17,696	17,655	54,544	53,086
Income before income tax expense	10,601	15,111	38,852	43,542
Provision for income tax expense	2,038	3,811	7,924	10,296
Net income	8,563	11,300	30,928	33,246
Less: Net income attributable to the noncontrolling interest	–	(252)	(1,358)	(1,301)
Net income attributable to Southside Bancshares, Inc.	\$8,563	\$11,048	\$29,570	\$31,945
Earnings per common share – basic	\$0.52	\$0.67	\$1.80	\$1.93
Earnings per common share – diluted	\$0.52	\$0.67	\$1.80	\$1.93
Dividends paid per common share	\$0.18	\$0.17	\$0.52	\$0.51

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(UNAUDITED)

(in thousands, except share amounts)

	Common Stock	Paid In Capital	Retained Earnings	Treasury Stock	Accu- mulated- Other Compre- hensive Income (Loss)	Noncon- trolling Interest	Total Equity
Balance at December 31, 2009	\$20,928	\$146,357	\$53,812	\$(23,545)	\$4,229	\$468	\$202,249
Comprehensive income:							
Net Income			31,945			1,301	33,246
Net unrealized gains on available for sale securities, net of tax					13,669		13,669
Reclassification adjustment for gains on sales of available for sale securities included in net income, net of tax					(14,966)		(14,966)
Noncredit portion of other-than-temporary impairment losses on available for sale securities, net of tax					23		23
Reclassification of other-than-temporary impairment charges on available for sale securities included in net income, net of tax					49		49
Adjustment to net periodic benefit cost, net of tax					611		611
Total comprehensive income							32,632
Issuance of common stock (136,419 shares)	171	1,080					1,251
Purchase of common stock (255,377 shares)				(4,716)			(4,716)
Tax benefit of incentive stock options		328					328

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Capital distribution to noncontrolling interest shareholders						(310)	(310)
Dividends paid on common stock (\$0.51 per share)			(7,916)				(7,916)
Stock dividend declared	943	14,570	(15,513)				–
Balance at September 30, 2010	\$22,042	\$162,335	\$62,328	\$(28,261)	\$3,615	\$1,459	\$223,518
Balance at December 31, 2010	\$22,075	\$162,877	\$64,179	\$(28,377)	\$(6,293)	\$1,113	\$215,574
Comprehensive income:							
Net Income			29,570			1,358	30,928
Net unrealized gains on available for sale securities, net of tax					30,551		30,551
Reclassification adjustment for gains on sales of available for sale securities included in net income, net of tax					(5,902)		(5,902)
Adjustment to net periodic benefit cost, net of tax					693		693
Total comprehensive income							56,270
Issuance of common stock (44,352 shares)	56	804					860
Stock compensation expense		143					143
Tax benefit of incentive stock options		2					2
Capital distribution to noncontrolling interest shareholders						(475)	(475)
Purchase of noncontrolling interest		(2,754)				(1,996)	(4,750)
Dividends paid on common stock (\$0.52 per share)			(8,414)				(8,414)
Stock dividend declared	981	15,014	(15,995)				–
Balance at September 30, 2011 (Restated)	\$23,112	\$176,086	\$69,340	\$(28,377)	\$19,049	\$–	\$259,210

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOW
(UNAUDITED)
(in thousands)

	Nine Months Ended September 30,	
	2011	2010
	(Restated)	
OPERATING ACTIVITIES:		
Net income	\$ 30,928	\$ 33,246
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation	2,515	2,397
Amortization of premium	26,175	25,982
Accretion of discount and loan fees	(3,386)	(3,497)
Provision for loan losses	5,452	9,328
Stock compensation expense	143	–
Deferred tax expense	561	998
Gain on sale of securities carried at fair value through income	(592)	–
Gain on sale of securities available for sale	(9,080)	(23,024)
Fair value (gain) loss – securities	(7,357)	–
FHLB advance option impairment charges	7,819	–
Net other-than-temporary impairment losses	–	75
Loss (gain) on sale of assets	3	(7)
Loss on retirement of assets	90	–
Impairment on other real estate owned	184	20
Gain on sale of other real estate owned	(242)	(26)
Net change in:		
Interest receivable	2,076	3,417
Other assets	(2,413)	(4,726)
Interest payable	(861)	(696)
Other liabilities	3,598	3,504
Loans held for sale	1,092	(3,241)
Net cash provided by operating activities	56,705	43,750
INVESTING ACTIVITIES:		
Securities held to maturity:		
Purchases	(11,875)	(258,935)
Maturities, calls and principal repayments	34,097	55,656
Securities available for sale:		
Purchases	(512,910)	(1,102,150)
Sales	516,571	1,060,449
Maturities, calls and principal repayments	195,097	280,606
Securities carried at fair value through income:		
Purchases	(707,222)	–
Sales	180,723	–
Maturities, calls and principal repayments	32,132	–
Proceeds from redemption of FHLB stock	16,461	2,638
Purchases of FHLB stock and other investments	(10,806)	(139)

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Net decrease (increase) in loans	27,344	(15,193)
Purchases of premises and equipment	(2,951)	(5,582)
Proceeds from sales of premises and equipment	6	38
Proceeds from sales of other real estate owned	676	948
Proceeds from sales of repossessed assets	3,933	3,713
Net cash (used in) provided by investing activities	(238,724)	22,049

(continued)

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOW
(UNAUDITED) (continued)
(in thousands)

	Nine Months Ended September 30,	
	2011	2010
	(Restated)	
FINANCING ACTIVITIES:		
Net increase in demand and savings accounts	133,513	117,405
Net increase in certificates of deposit	30,099	49,927
Net decrease in federal funds purchased and repurchase agreements	(847)	(9,514)
Proceeds from FHLB advances	8,005,080	6,119,530
Repayment of FHLB advances	(8,004,991)	(6,304,778)
Net capital distributions to noncontrolling interest in consolidated entities	(475)	(310)
Purchase of noncontrolling interest	(4,750)	–
Tax benefit of incentive stock options	2	328
Purchase of common stock	–	(4,716)
Proceeds from the issuance of common stock	860	1,251
Dividends paid	(8,414)	(7,916)
Net cash provided by (used in) financing activities	150,077	(38,793)
Net (decrease) increase in cash and cash equivalents	(31,942)	27,006
Cash and cash equivalents at beginning of period	79,073	52,166
Cash and cash equivalents at end of period	\$47,131	\$79,172

SUPPLEMENTAL DISCLOSURES FOR CASH FLOW INFORMATION:

Interest paid	\$28,301	\$35,525
Income taxes paid	\$6,500	\$9,550

SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:

Acquisition of other repossessed assets and real estate through foreclosure	\$4,790	\$5,416
Adjustment to pension liability	\$(1,066)	\$(939)
5% stock dividend	\$15,995	\$15,513
Unsettled trades to purchase securities	\$–	\$(18,160)
Unsettled trades to sell securities	\$–	\$18,723

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

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SOUTHSIDE BANCSHARES, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

1. Basis of Presentation

In this report, the words “the Company,” “we,” “us,” and “our” refer to the combined entities of Southside Bancshares, Inc. and its subsidiaries. The words “Southside” and “Southside Bancshares” refer to Southside Bancshares, Inc. The words “Southside Bank” and “the Bank” refer to Southside Bank (which, subsequent to the internal merger of Fort Worth National Bank (“FWNB”) with and into Southside Bank, includes FWNB). “FWBS” refers to Fort Worth Bancshares, Inc., a bank holding company acquired by Southside of which FWNB was a wholly-owned subsidiary. “SFG” refers to Southside Financial Group, LLC, of which Southside Bank owns a 100% interest as of September 30, 2011. On July 15, 2011, Southside Bank acquired the remaining 50% interest in SFG increasing our ownership to 100%. The purchase price was \$4.8 million and resulted in a decrease to shareholders’ equity of approximately \$2.8 million and the elimination of the noncontrolling interest. SFG is consolidated in our financial statements and this purchase will not limit or change our ability to allocate capital.

The consolidated balance sheet as of September 30, 2011, and the related consolidated statements of income, equity and cash flows and notes to the financial statements for the three and nine month periods ended September 30, 2011 and 2010 are unaudited; in the opinion of management, all adjustments necessary for a fair statement of such financial statements have been included. Such adjustments consisted only of normal recurring items. All significant intercompany accounts and transactions are eliminated in consolidation. The preparation of these consolidated financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires the use of management’s estimates. These estimates are subjective in nature and involve matters of judgment. Actual amounts could differ from these estimates.

Interim results are not necessarily indicative of results for a full year. These financial statements should be read in conjunction with the financial statements and notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2010. All share data has been adjusted to give retroactive recognition to stock splits and stock dividends.

Summary of Significant Accounting and Reporting Policies

Securities Carried at Fair Value through Income. Debt securities purchased at significant premiums that contain an embedded derivative where the embedded derivative is not readily identifiable and measurable and as such cannot be bifurcated, are classified as securities carried at fair value through income. Fair value is determined using quoted market prices. If quoted market prices are not available, fair values are based on quoted market prices for similar securities or estimates from independent pricing services. Changes in fair value are reported through the income statement as fair value gain (loss) – securities.

FHLB Advance Option Fees. Option fees paid to the FHLB giving us the option to enter into long-term advance commitments at specified interest rates in the future are capitalized and reviewed for impairment. Once the option is exercised, the FHLB advance option fee is amortized over the term of the advance as interest expense.

For a description of our other significant accounting and reporting policies, refer to Note 1 of the Notes to Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2010.

Accounting Standards

ASU No. 2011-01, “Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 (Topic 310)”, was issued January 2011 deferring the new disclosure requirements (paragraphs 310-10-50-31 through 50-34 of the FASB Accounting Standards Codification) about troubled debt restructurings to be concurrent with the effective date of the guidance for determining what constitutes a troubled debt restructuring, as presented in proposed Accounting Standards Update, Receivables (Topic 310): Clarifications to Accounting for Troubled Debt Restructurings by Creditors. As a result of the issuance of Update 2011-02, the provisions of Update 2011-01 became effective for us on September 30, 2011, and was applied retrospectively to the beginning of the annual period of adoption. The adoption of the Update did not have a material effect on our consolidated financial statements.

ASU No. 2011-02, “Receivables (Topic 310) - A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring.” ASU 2011-02 clarifies which loan modifications constitute troubled debt restructurings and is intended to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment loss and for disclosure of troubled debt restructurings. In evaluating whether a restructuring constitutes a troubled debt restructuring, a creditor must separately conclude, under the guidance clarified by ASU 2011-02, that both of the following exist: (a) the restructuring constitutes a concession; and (b) the debtor is experiencing financial difficulties. ASU 2011-02 became effective for us on July 1, 2011, and was applied retrospectively to restructurings occurring on or after January 1, 2011. The adoption of ASU 2011-02 did not have a significant impact on our consolidated financial statements.

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ASU No. 2011-03, “Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreements.” ASU 2011-03 is intended to improve financial reporting of repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU 2011-03 removes from the assessment of effective control (i) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (ii) the collateral maintenance guidance related to that criterion. ASU 2011-03 will be effective for us on January 1, 2012 and is not expected to have a significant impact on our consolidated financial statements.

ASU 2011-04, “Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs.” ASU 2011-04 amends Topic 820, “Fair Value Measurements and Disclosures,” to converge the fair value measurement guidance in U.S. generally accepted accounting principles and International Financial Reporting Standards. ASU 2011-04 clarifies the application of existing fair value measurement requirements, changes certain principles in Topic 820 and requires additional fair value disclosures. ASU 2011-04 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on our consolidated financial statements.

ASU 2011-05, “Comprehensive Income (Topic 220) - Presentation of Comprehensive Income.” ASU 2011-05 amends Topic 220, “Comprehensive Income,” to require that all nonowner changes in stockholders’ equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. Additionally, ASU 2011-05 requires entities to present, on the face of the financial statements, reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement or statements where the components of net income and the components of other comprehensive income are presented. The option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity was eliminated. ASU 2011-05 is effective for annual periods beginning after December 15, 2011, and is not expected to have a significant impact on our consolidated financial statements.

ASU 2011-08, “Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment.” ASU 2011-08 amends Topic 350, “Intangibles – Goodwill and Other,” to give entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount of the reporting unit. ASU 2011-08 is effective for annual and interim impairment tests beginning after December 15, 2011, and is not expected to have a significant impact on our consolidated financial statements.

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2. Restatement of Previously Issued Financial Statements

During the preparation of the 2011 Form 10-K, we determined that in periods prior to December 31, 2011, we incorrectly accounted for securities acquired with a significant purchase premium that included an embedded derivative. These securities were mainly acquired in 2010 and 2011. Pursuant to GAAP, we are required to bifurcate and account for the embedded derivative separately or to account for the securities including the embedded derivative at fair value through income, if the bifurcation was impractical. We determined that valuing the embedded derivative separately was not readily identifiable and measurable and as such, cannot be bifurcated. Therefore, we determined that all securities meeting the above criteria should be reflected at fair value with the change in fair value reflected through income.

In addition to the error related to the accounting for securities with an embedded derivative mentioned above, we determined that during the first three quarters of 2011, we incorrectly priced securities acquired with a significant premium and that we did not account for the impairment of FHLB advance option fees that became impaired during the third quarter of 2011.

We evaluated the effect of these errors and concluded that they were immaterial to any of the previously issued consolidated financial statements except for the unaudited consolidated financial statements included in the Company's Quarterly Reports on Form 10-Q for the periods ended March 31, June 30, and September 30, 2011. Accordingly, on March 8, 2012, we filed a Form 8-K reporting that our Audit Committee of the Board of Directors determined based on the recommendation of management, that we should restate our unaudited consolidated financial statements in each of these Quarterly Reports on Form 10-Q. In addition, we revised our 2010 consolidated financial statements in the 2011 Form 10-K to correct for these errors.

The aggregate income resulting from the changes in the fair value of certain securities for the first three quarters of 2011 was approximately \$7.4 million, which should have been recorded between the first three quarterly periods of 2011. The impairment charge for the FHLB advance option fees was approximately \$7.8 million, all of which should have been recorded in the third quarter of 2011.

The correction of the errors resulted in a decrease in net income of \$3.0 million for the three months ended September 30, 2011 resulting in net income of \$8.6 million for that period, and a decrease in net income of approximately \$300,000 for the nine months ended September 30, 2011, resulting in net income attributable to Southside Bancshares, Inc. of \$29.6 million for that period.

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A summary of the adjustments made and their effect on the financial statements is presented below (dollars in thousands):

Consolidated Balance Sheet	As of September 30, 2011		
	As Originally Reported	Corrections	As Restated
Mortgage-backed and related securities:			
Available for sale, at estimated fair value (1)	\$1,263,528	\$(548,336)	\$715,192
Securities carried at fair value through income (1)	–	567,639	567,639
Held to maturity, at amortized cost (1)	389,178	(9,842)	379,336
Other assets (2)	56,006	(7,820)	48,186
Total assets	3,210,279	1,641	3,211,920
Deferred tax liability (3)	7,030	574	7,604
Total liabilities	2,952,136	574	2,952,710
Retained earnings (4)	70,028	(688)	69,340
Accumulated other comprehensive income (loss) (5)	17,294	1,755	19,049
Total shareholders' equity	258,143	1,067	259,210
Total equity	258,143	1,067	259,210
Total liabilities and equity	3,210,279	1,641	3,211,920

“As Originally Reported” reflects balances reported in the September 30, 2011 Form 10-Q filed on November 8, 2011.

“As Restated” reflects the final restated balances.

“Corrections” reflect changes to the originally reported balances and are described below.

Balance Sheet Corrections:

- (1) The decrease in mortgage-backed securities available for sale and held to maturity for the nine months ended September 30, 2011 reflects the reclassification of securities with an embedded derivative and purchased at a significant premium, which we have defined as greater than 111.111%, to securities carried at fair value through income.
- (2) Reflects the impairment charge for FHLB advance option fees at September 30, 2011 of approximately \$7.8 million, all of which has been recorded in the third quarter of 2011.
- (3) The correction to the deferred tax liability occurred as a result of recording the fair value on the securities through income rather than accumulated other comprehensive income. In addition, the deferred tax liability changed as a result of the deferral of tax deductibility on the impairment charges on the FHLB advance option fees that was partially offset by the fair value gain on securities carried at fair value through income.
- (4) Retained earnings decreased due to the impairment of the FHLB advance option fees that were partially offset by the increase in fair value gains on securities carried at fair value through income for the nine months ended

September 30, 2011.

- (5) Accumulated other comprehensive income increased as a result of reversing the incorrect fair values on the securities previously classified as available for sale at September 30, 2011.

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Consolidated Statement of Income	For the nine months ended September 30, 2011		
	As		
	Originally Reported	Corrections	As Restated
Gain on sale of securities available for sale (1)	\$9,672	\$(592)	\$9,080
Gain on sale of securities carried at fair value through income (1)	–	592	592
Fair value gain (loss) – securities (2)	–	7,357	7,357
FHLB advance option impairment charges (3)	–	(7,819)	(7,819)
Total noninterest income	28,468	(462)	28,006
Income before income tax expense	39,314	(462)	38,852
Provision for income tax expense (4)	8,086	(162)	7,924
Net income	31,228	(300)	30,928
Net income attributable to Southside Bancshares, Inc.	29,870	(300)	29,570
Earnings per common share – basic	1.82	(0.02)	1.80
Earnings per common share – diluted	1.82	(0.02)	1.80

Consolidated Statement of Income	For the three months ended September 30, 2011		
	As		
	Originally Reported	Corrections	As Restated
Gain on sale of securities available for sale (1)	\$3,863	\$(254)	\$3,609
Gain on sale of securities carried at fair value through income (1)	–	254	254
Fair value gain (loss) – securities (2)	–	3,274	3,274
FHLB advance option impairment charges (3)	–	(7,819)	(7,819)
Total noninterest income	10,280	(4,545)	5,735
Income before income tax expense	15,146	(4,545)	10,601
Provision for income tax expense (4)	3,629	(1,591)	2,038
Net income	11,517	(2,954)	8,563
Net income attributable to Southside Bancshares, Inc.	11,517	(2,954)	8,563
Earnings per common share – basic	0.70	(0.18)	0.52
Earnings per common share – diluted	0.70	(0.18)	0.52

“As Originally Reported” reflects balances reported in the September 30, 2011 Form 10-Q filed on November 8, 2011.

“As Restated” reflects the final restated balances.

“Corrections” reflect changes to the originally reported balances and are described below.

Income Statement Corrections:

- (1) The change in gains on securities available for sale is a result of reclassifying gains on sales of securities carried at fair value through income separately in the statement of income.

- (2) The correction to fair value gain (loss) – securities is a result of recording the changes in fair value on securities carried at fair value through the income statement rather than accumulated other comprehensive income.
- (3) The correction to FHLB advance option impairment charges is the result of the write-down in value of the FHLB advance option fees carried on the balance sheet in other assets.
- (4) The change in provision (benefit) for income tax expense is a direct result of the changes in income.

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September 30, 2011As
Originally
Reported Corrections As Restated

Consolidated Statement of Changes in Equity

Retained earnings:			
Balance, beginning of period	\$64,567	\$(388)	\$64,179
Net income attributable to Southside Bancshares, Inc.	29,870	(300)	29,570
Balance, end of period	70,028	(688)	69,340
Accumulated other comprehensive income (loss):			
Balance, beginning of period	(6,819)	526	(6,293)
Net unrealized gains on available for sale securities, net of tax	29,707	844	30,551
Reclassification adjustment for gains on sales of available for sale securities included in net income, net of tax	(6,287)	385	(5,902)
Net change in accumulated other comprehensive income (loss)	24,113	1,229	25,342
Balance, end of period	17,294	1,755	19,049
Total shareholders' equity	258,143	1,067	259,210
Total equity	258,143	1,067	259,210
Comprehensive income:			
Net income	31,228	(300)	30,928
Net change in accumulated other comprehensive income (loss)	24,113	1,229	25,342
Comprehensive income	55,341	929	56,270
Comprehensive income attributable to Southside Bancshares, Inc.	53,983	929	54,912

Consolidated Statement of Cash Flow

Operating Activities:			
Net income	\$31,228	\$(300)	\$30,928
Deferred tax expense (benefit)	723	(162)	561
Gain on sale of securities carried at fair value through income	–	(592)	(592)
Gain on sale of securities available for sale	(9,672)	592	(9,080)
Fair value gain (loss) – securities	–	(7,357)	(7,357)
FHLB advance option impairment charges	–	7,819	7,819
Net cash provided by operating activities	56,705	–	56,705
Investing Activities:			
Securities held to maturity:			
Maturities, calls and principal repayments	35,876	(1,779)	34,097
Securities available for sale:			
Purchases	(1,220,132)	707,222	(512,910)
Sales	697,294	(180,723)	516,571
Maturities, calls and principal repayments	225,450	(30,353)	195,097
Securities carried at fair value through income:			

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Purchases	–	(707,222)	(707,222)
Sales	–	180,723	180,723
Maturities, calls and principal repayments	–	32,132	32,132
Net cash used in investing activities	(238,724)	–	(238,724)

“As Originally Reported” reflects balances reported in the September 30, 2011 Form 10-Q filed November 8, 2011.

“As Restated” reflects the final restated balances.

“Corrections” reflect changes to the originally reported balances.

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3. Earnings Per Share - (2011 Restated)

Earnings per share attributable to Southside Bancshares, Inc. on a basic and diluted basis have been adjusted to give retroactive recognition to stock splits and stock dividends and is calculated as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Basic and Diluted Earnings:				
Net income – Southside Bancshares, Inc.	\$8,563	\$11,048	\$29,570	\$31,945
Basic weighted-average shares outstanding	16,454	16,543	16,439	16,563
Add: Stock options	7	10	7	35
Diluted weighted-average shares outstanding	16,461	16,553	16,446	16,598
Basic Earnings Per Share:				
Net Income - Southside Bancshares, Inc.	\$0.52	\$0.67	\$1.80	\$1.93
Diluted Earnings Per Share:				
Net Income - Southside Bancshares, Inc.	\$0.52	\$0.67	\$1.80	\$1.93

On March 31, 2011, our board of directors declared a 5% stock dividend to common stock shareholders of record as of April 20, 2011, and payable on May 11, 2011.

During the second quarter, our board of directors approved equity grants in the form of stock options and restricted stock units. These equity grants were made pursuant to the shareholder-approved Southside Bancshares, Inc. 2009 Incentive Plan.

For the three and nine month periods ended September 30, 2011, there were approximately 28,000 and 9,000 antidilutive options, respectively. For the three and nine months ended September 30, 2010, there were no antidilutive options.

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4. Comprehensive Income (Loss) - (2011 Restated)

The components of other comprehensive income (loss) are as follows (in thousands):

	Nine Months Ended September 30, 2011		
	Before-Tax Amount	Tax Expense	Net-of-Tax Amount
Unrealized gains on securities:			
Unrealized holding gains arising during period	\$47,002	\$(16,451)	\$30,551
Less: reclassification adjustment for gains included in net income	9,080	(3,178)	5,902
Net unrealized gains on securities	37,922	(13,273)	24,649
Change in pension plans	1,066	(373)	693
Other comprehensive income	\$38,988	\$(13,646)	\$25,342

	Three Months Ended September 30, 2011		
	Before-Tax Amount	Tax Expense	Net-of-Tax Amount
Unrealized gains on securities:			
Unrealized holding gains arising during period	\$20,722	\$(7,253)	\$13,469
Less: reclassification adjustment for gains included in net income	3,609	(1,263)	2,346
Net unrealized gains on securities	17,113	(5,990)	11,123
Change in pension plans	355	(124)	231
Other comprehensive income	\$17,468	\$(6,114)	\$11,354

	Nine Months Ended September 30, 2010		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding gains arising during period	\$21,029	\$(7,360)	\$13,669
Noncredit portion of other-than-temporary impairment losses on the AFS securities	36	(13)	23
Less: reclassification adjustment for gains included in net income	23,024	(8,058)	14,966
Less: reclassification of other-than-temporary impairment charges on AFS securities included in net income	(75)	26	(49)
Net unrealized losses on securities	(1,884)	659	(1,225)
Change in pension plans	939	(328)	611
Other comprehensive loss	\$(945)	\$331	\$(614)

	Three Months Ended September 30, 2010		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized losses on securities:			
Unrealized holding gains arising during period	\$7,170	\$(2,509)	\$4,661
Noncredit portion of other-than-temporary impairment losses on the AFS securities	—	—	—
Less: reclassification adjustment for gains included in net income	8,008	(2,802)	5,206
Less: reclassification of other-than-temporary impairment charges on AFS securities included in net income	—	—	—
Net unrealized losses on securities	(838)	293	(545)

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Change in pension plans	313	(109)	204	
Other comprehensive loss	\$(525)	\$ 184	\$(341)

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5. Securities - (2011 Restated)

The amortized cost and estimated market value of investment and mortgage-backed securities as of September 30, 2011 and December 31, 2010, are reflected in the tables below (in thousands):

	September 30, 2011				Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Noncredit OTTI	Other	
AVAILABLE FOR SALE:					
Investment Securities:					
State and Political Subdivisions	\$275,170	\$28,906	\$-	\$29	\$304,047
Other Stocks and Bonds	2,925	-	1,978	-	947
Mortgage-backed Securities:					
U.S. Government Agencies	115,394	6,996	-	98	122,292
Government-Sponsored Enterprises	574,232	19,551	-	883	592,900
Total	\$967,721	\$55,453	\$1,978	\$1,010	\$1,020,186

	September 30, 2011				Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Noncredit OTTI	Other	
HELD TO MATURITY:					
Investment Securities:					
State and Political Subdivisions	\$1,011	\$188	\$-	\$-	\$1,199
Other Stocks and Bonds	485	18	-	-	503
Mortgage-backed Securities:					
U.S. Government Agencies	23,556	1,124	-	75	24,605
Government-Sponsored Enterprises	355,780	13,546	-	10	369,316
Total	\$380,832	\$14,876	\$-	\$85	\$395,623

	December 31, 2010				Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Noncredit OTTI	Other	
AVAILABLE FOR SALE:					
Investment Securities:					
U.S. Treasury	\$4,700	\$-	\$-	\$-	\$4,700
State and Political Subdivisions	296,357	4,445	-	6,540	294,262
Other Stocks and Bonds	3,117	1	2,736	-	382
Mortgage-backed Securities:					
U.S. Government Agencies	145,136	5,296	-	159	150,273
Government-Sponsored Enterprises	721,908	16,035	-	1,642	736,301
Total	\$1,171,218	\$25,777	\$2,736	\$8,341	\$1,185,918

December 31, 2010		Gross Unrealized Losses		Estimated
Amortized	Gross Unrealized	Noncredit		