

ACNB CORP  
Form 10-K  
March 12, 2012

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, DC 20549

**FORM 10-K**

(Mark One)

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

**For the fiscal year-ended December 31, 2011**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-11783**

**ACNB CORPORATION**

(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**23-2233457**  
(I.R.S. Employer  
Identification No.)

**16 Lincoln Square, Gettysburg, Pennsylvania**  
(Address of principal executive offices)

**17325**  
(Zip Code)

Registrant's telephone number, including area code: **(717) 334-3161**

Securities registered pursuant to Section 12(b) of the Act:

**Title of each class**

Common Stock, \$2.50 par value per share

**Name of each exchange on which registered**

The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition 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

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

The aggregate market value of the voting stock held by nonaffiliates of the registrant at June 30, 2011, was approximately \$91,142,000.

The number of shares of the registrant's common stock outstanding on March 9, 2012, was 5,945,809.

### **Documents Incorporated by Reference**

Portions of the registrant's 2012 definitive Proxy Statement are incorporated by reference into Part III of this report.

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**PART I**

**FORWARD-LOOKING STATEMENTS**

In addition to historical information, this Form 10-K contains forward-looking statements. Examples of forward-looking statements include, but are not limited to, (a) projections or statements regarding future earnings, expenses, net interest income, other income, earnings or loss per share, asset mix and quality, growth prospects, capital structure, and other financial terms, (b) statements of plans and objectives of management or the Board of Directors, and (c) statements of assumptions, such as economic conditions in the Corporation's market areas. Such forward-looking statements can be identified by the use of forward-looking terminology such as "believes", "expects", "may", "intends", "will", "should", "anticipates", or the negative of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy. Forward-looking statements are subject to certain risks and uncertainties such as local economic conditions, competitive factors, and regulatory limitations. Actual results may differ materially from those projected in the forward-looking statements. Such risks, uncertainties and other factors that could cause actual results and experience to differ from those projected include, but are not limited to, the following: the effects of new laws and regulations, specifically the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act; ineffectiveness of the business strategy due to changes in current or future market conditions; the effects of economic deterioration on current customers, specifically the effect of the economy on loan customers' ability to repay loans; the effects of competition, and of changes in laws and regulations on competition, including industry consolidation and development of competing financial products and services; interest rate movements; the inability to achieve acquisition-related synergies; difficulties in integrating distinct business operations, including information technology difficulties; disruption from the transaction making it more difficult to maintain relationships with customers and employees, and challenges in establishing and maintaining operations in new markets; volatilities in the securities markets; and, deteriorating economic conditions. We caution readers not to place undue reliance on these forward-looking statements. They only reflect management's analysis as of this date. The Corporation does not revise or update these forward-looking statements to reflect events or changed circumstances. Please carefully review the risk factors described in other documents the Corporation files from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K.

**ITEM 1 BUSINESS**

**ACNB CORPORATION**

ACNB Corporation (the Corporation or ACNB) is a \$1.0 billion financial holding company headquartered in Gettysburg, Pennsylvania. Through its banking and nonbanking subsidiaries, ACNB provides a full range of banking and financial services to individuals and businesses, including commercial and retail banking, trust and investment management, and insurance. ACNB's banking operations are conducted through its primary operating subsidiary, ACNB Bank, with 19 retail banking offices in Adams, Cumberland and York Counties, as well as two loan production offices in York and Franklin Counties, Pennsylvania, as of December 31, 2011. The Corporation was formed in 1982, then became the holding company for Adams County National Bank (now ACNB Bank) in 1983.

On January 5, 2005, ACNB Corporation completed the acquisition of Russell Insurance Group, Inc. (RIG) and RIG began to operate as a separate subsidiary of ACNB Corporation. In accordance with the terms of the acquisition, there was contingent consideration associated with this transaction of up to \$3,000,000, payable in 2008 subject to performance criteria for the three-year period subsequent to the acquisition. Due to performance at a higher level than the performance criteria, the liability for this consideration was recorded at December 31, 2006, with a related increase in goodwill. Payment was made in the second quarter of 2008 after it was ascertained that the

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performance criteria had been met for the full three-year period; after which, the total aggregate purchase price was \$8,663,000. In addition, on January 13, 2011, the Corporation entered into another three-year employment agreement with Frank C. Russell, Jr., President & Chief Executive Officer of RIG, effective as of January 1, 2011.

In 2007, RIG acquired two additional books of business with an aggregate purchase price of \$637,000. In 2008, RIG acquired an additional book of business with an aggregate purchase price of \$1,165,000, all of which was classified as an intangible asset. Also, on December 31, 2008, RIG acquired Marks Insurance & Associates, Inc. with an aggregate purchase price of \$1,853,000, of which \$1,300,000 was recorded as an intangible asset and \$553,000 was recorded as goodwill. The contingent consideration for both 2008 purchases was calculated based on 2011 results of operation. The contingent amount of \$338,000 was recorded in December 2011 and is included in goodwill and the other liabilities section of the statement of condition, and was subsequently paid on January 13, 2012. The intangible assets (excluding goodwill) are being amortized over ten years on a straight line basis.

ACNB's major source of operating funds is dividends that it receives from its subsidiary bank. ACNB's expenses consist principally of losses from low-income housing investments and interest paid on a term loan used to purchase RIG. Dividends that ACNB pays to stockholders consist of dividends declared and paid to ACNB by the subsidiary bank.

ACNB and its subsidiaries are not dependent upon a single customer or a small number of customers, the loss of which would have a material adverse effect on the Corporation. ACNB does not depend on foreign sources of funds, nor does it make foreign loans.

The common stock of ACNB is listed on The NASDAQ Capital Market under the symbol ACNB.

RIG is managed separately from the banking and related financial services that the Corporation offers and is reported as a separate segment. Financial information on this segment is included in Notes to Consolidated Financial Statements, Note S "Segment and Related Information".

**BANKING SUBSIDIARY**

*ACNB Bank*

On October 4, 2010, the banking subsidiary, Adams County National Bank, completed the process of converting from a national banking association to a Pennsylvania state-chartered bank and trust company with the filing and effectiveness of its Articles of Conversion with the Pennsylvania Department of State. Accordingly, Adams County National Bank became ACNB Bank (Bank). Reasons for the conversion included the Corporation's belief that a state bank charter serves the needs of a community bank more effectively. The Pennsylvania Department of Banking focuses solely on Pennsylvania financial institutions, so there was an anticipation of a better understanding of the Bank and the environment in which it operates, as well as an enhanced level of communication. In addition, the Bank serves customers in four counties Adams, Cumberland, York and Franklin and the name of Adams County National Bank no longer served the organization well in expansion beyond Adams County.

ACNB Bank is a full-service commercial bank operating under charter from the Pennsylvania Department of Banking. The Bank's principal market area is Adams County, Pennsylvania, which is located in southcentral Pennsylvania. Adams County depends on agriculture, industry and tourism to provide employment for its residents. No single sector dominates the county's economy. At December 31, 2011, ACNB Bank had total assets of \$989 million, total gross loans of \$694 million, and total deposits of \$785 million.

The main office of the Bank is located at 16 Lincoln Square, Gettysburg, Pennsylvania. In addition to its main office, as of December 31, 2011, the Bank had thirteen branches in Adams County, four

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branches in York County, and one branch in Cumberland County, as well as a loan production office in both York County and Franklin County, Pennsylvania. ACNB Bank's service delivery channels for its customers also include the ATM network, Customer Contact Center, and Online and Telephone Banking. The Bank is subject to regulation and periodic examination by the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation (FDIC). The FDIC, as provided by law, insures the Bank's deposits.

Commercial lending includes commercial mortgages, real estate development and construction, accounts receivable and inventory financing, and agricultural loans. Consumer lending programs include home equity loans and lines of credit, automobile and recreational vehicle loans, manufactured housing loans, and personal lines of credit. Mortgage lending programs include personal residential mortgages, residential construction loans, and investment mortgage loans.

A trust is a legal fiduciary agreement whereby the ACNB Bank Trust Department is named as trustee of financial assets. As trustee, the Trust Department invests, protects, manages and distributes financial assets as defined in the agreement. Estate settlement governed by the last will and testament of an individual constitutes another part of the Trust Department business. One purpose of having a will is to name an executor to settle an estate. ACNB Bank has the knowledge and expertise to act as executor. Other services include, but are not limited to, services under testamentary trusts, life insurance trusts, charitable remainder trusts, guardianships, and powers of attorney.

**NONBANKING SUBSIDIARIES**

*Russell Insurance Group, Inc.*

In January 2005, ACNB Corporation acquired Russell Insurance Group, Inc. (RIG), a full-service insurance agency that offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients. Based in Westminster, Maryland, RIG has served the needs of its clients since its founding as an independent insurance agency by Frank C. Russell, Jr. in 1978. With the acquisition of Marks Insurance & Associates, Inc. as of December 31, 2008, RIG operates a second office location in Germantown, Maryland. Total assets of RIG as of December 31, 2011, totaled \$12,571,000.

*BankersRe Insurance Group, SPC*

BankersRe Insurance Group, SPC (formerly Pennbanks Insurance Co., SPC) was organized in 2000 and holds an unrestricted Class "B" Insurer's License under Cayman Islands Insurance Law. The segregated portfolio is engaged in the business of reinsuring credit life and credit accident and disability risks. Total assets of the segregated portfolio as of December 31, 2011, totaled \$209,000.

**MARKET AREA ECONOMIC FEATURES AND CONDITIONS**

ACNB Corporation, headquartered in Gettysburg, Pennsylvania, is the financial holding company for the wholly-owned subsidiaries of ACNB Bank, Gettysburg, Pennsylvania, and Russell Insurance Group, Inc., Westminster, Maryland. ACNB Bank serves its marketplace via a network of 19 retail banking offices located throughout Adams County, Pennsylvania, as well as in Dillsburg, Hanover and Spring Grove, York County, Pennsylvania, and in Newville, Cumberland County, Pennsylvania. In addition, the Bank operates loan offices in Hanover, York County, and Chambersburg, Franklin County, Pennsylvania. Russell Insurance Group, Inc. offers a broad range of commercial and personal insurance lines with licenses in 36 states, including Pennsylvania and Maryland, through offices in Westminster, Carroll County, and Germantown, Montgomery County, Maryland. Accordingly, ACNB Corporation's major operations are in the more rural areas of the Harrisburg-Carlisle MSA and the York-Hanover MSA, along with all of Adams County, Pennsylvania, and parts of Franklin County, Pennsylvania. Approximately 60% of the population resides in areas designated rural. Major types of

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employers include those focused on manufacturing, education, healthcare, agriculture, tourism, and transportation/warehousing, as well as local governments. A material amount of land surrounding Gettysburg is under control of the National Park Service, limiting certain types of development. Unemployment figures recently, and historically, have been better than those for Pennsylvania and the United States. Per capita and household incomes are generally under Pennsylvania averages.

**COMPETITION**

The financial services industry in ACNB's market area is highly competitive, including competition for similar products and services from commercial banks, credit unions, finance and mortgage companies, and other nonbank providers of financial services. Several of ACNB's competitors have legal lending limits that exceed those of ACNB's subsidiary bank, as well as funding sources on the capital markets that exceed ACNB's availability. The increased competition has resulted from a changing legal and regulatory environment, as well as from the economic climate, customer expectations, and service alternatives via the Internet.

**SUPERVISION AND REGULATION**

*Regulation of Bank Holding Company and Subsidiaries*

**BANK HOLDING COMPANY ACT OF 1956** ACNB is a financial holding company and is subject to the regulations of the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956. Bank holding companies are required to file periodic reports with and are subject to examination by the Federal Reserve. The Federal Reserve has issued regulations under the Bank Holding Company Act that require a financial holding company to serve as a source of financial and managerial strength to its subsidiary bank. As a result, the Federal Reserve may require ACNB to stand ready to use its resources to provide adequate capital funds to the Bank during periods of financial stress or adversity.

In addition, the Federal Reserve may require a financial holding company to end a nonbanking business if the nonbanking business constitutes a serious risk to the financial soundness and stability of any banking subsidiary of the financial holding company.

The Bank Holding Company Act prohibits ACNB from acquiring direct or indirect control of more than 5% of the outstanding voting stock of any bank, or substantially all of the assets of any bank, or merging with another bank holding company, without the prior approval of the Federal Reserve. The Bank Holding Company Act allows interstate bank acquisitions and interstate branching by acquisition and consolidation in those states that had not elected to opt out by the required deadline. The Pennsylvania Department of Banking also must approve any similar consolidation. Pennsylvania law permits Pennsylvania financial holding companies to control an unlimited number of banks.

Further, the Bank Holding Company Act restricts ACNB's nonbanking activities to those that are determined by the Federal Reserve Board to be financial in nature, incidental to such financial activity, or complementary to a financial activity. The Bank Holding Company Act does not place territorial restrictions on the activities of nonbanking subsidiaries of financial holding companies.

**GRAMM-LEACH-BLILEY ACT OF 1999 (GLBA)** The Gramm-Leach-Bliley Act of 1999 eliminated many of the restrictions placed on the activities of bank holding companies that become financial holding companies. Among other things, the Gramm-Leach-Bliley Act repealed certain Glass-Steagall Act restrictions on affiliations between banks and securities firms, and amended the Bank Holding Company Act to permit bank holding companies that are financial holding companies to engage in activities, and acquire companies engaged in activities, that are: financial in nature (including insurance underwriting, insurance company portfolio investment, financial advisory, securities underwriting, dealing and market-making, and merchant banking activities); incidental to financial



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activities; or, complementary to financial activities if the Federal Reserve determines that they pose no substantial risk to the safety or soundness of depository institutions or the financial system in general.

**REGULATION W** Transactions between a bank and its "affiliates" are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Deposit Insurance Act applies Sections 23A and 23B to insured nonmember banks in the same manner and to the same extent as if they were members of the Federal Reserve System. The Federal Reserve has also issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act, and interpretative guidance with respect to affiliate transactions. Regulation W incorporates the exemption from the affiliate transaction rules, but expands the exemption to cover the purchase of any type of loan or extension of credit from an affiliate. Affiliates of a bank include, among other entities, the bank's holding company and companies that are under common control with the bank. ACNB Corporation and Russell Insurance Group, Inc. are considered to be affiliates of ACNB Bank.

**USA PATRIOT ACT OF 2001** In October 2001, the USA Patriot Act of 2001 was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C., which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcement's and the intelligence communities' abilities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

**SARBANES-OXLEY ACT OF 2002 (SOA)** In 2002, the Sarbanes-Oxley Act of 2002 became law. The stated goals of the SOA are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly-traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities law.

The SOA is the most far-reaching U.S. securities legislation enacted in some time. The SOA generally applies to all companies, both U.S. and non-U.S., that file or are required to file periodic reports with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934, or the Exchange Act.

The SOA includes very specific additional disclosure requirements and corporate governance rules, as well as requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance, and other related rules. The SOA represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

The SOA addresses, among other matters:

Audit committees for all reporting companies;

Certification of financial statements by the chief executive officer and the chief financial officer;

The forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve-month period following initial publication of any financial statements that later require restatement;

A prohibition on insider trading during pension plan blackout periods;

Disclosure of off-balance sheet transactions;

A prohibition on personal loans to directors and officers;

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Expedited filing requirements for Forms 4;

Disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code;

"Real time" filing of periodic reports;

Formation of a public accounting oversight board;

Auditor independence; and,

Increased criminal penalties for violations of securities laws.

The SEC has been delegated the task of enacting rules to implement various provisions with respect to, among other matters, disclosure in periodic filings pursuant to the Exchange Act.

**AMERICAN JOBS CREATION ACT OF 2004** In 2004, the American Jobs Creation Act was enacted as the first major corporate tax act in years. The act addresses a number of areas of corporate taxation including executive deferred compensation restrictions. The impact of the act on ACNB is not material.

**BANK SECRECY ACT** Under the Bank Secrecy Act, banks and other financial institutions are required to report to the Internal Revenue Service currency transactions of more than \$10,000 or multiple transactions of which a bank is aware in any one day that aggregate in excess of \$10,000 and to report suspicious transactions under specified criteria. Civil and criminal penalties are provided under the Bank Secrecy Act for failure to file a required report, for failure to supply information required by the Bank Secrecy Act, or for filing a false or fraudulent report.

**DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (DODD-FRANK)** In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Dodd-Frank is intended to effect a fundamental restructuring of federal banking regulation. Among other things, Dodd-Frank created a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. Dodd-Frank additionally created a new independent federal regulator to administer federal consumer protection laws. Dodd-Frank has and is expected to have a significant impact on ACNB's business operations as its provisions take effect. It is expected that, as various implementing rules and regulations are released, they will increase ACNB's operating and compliance costs and could increase the Bank's interest expense. Among the provisions that are likely to affect ACNB are the following:

*Holding Company Capital Requirements*

Dodd-Frank requires the Federal Reserve to apply consolidated capital requirements to bank holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010, by a bank holding company with less than \$15 billion in assets. Dodd-Frank additionally requires that bank regulators issue countercyclical capital requirements so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness.

*Deposit Insurance*

Dodd-Frank permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to \$250,000 per depositor, and extends unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012. Dodd-Frank also broadens the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. Dodd-Frank requires the FDIC to increase

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the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Effective one year from the date of enactment, on July 21, 2011, Dodd-Frank eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

*Corporate Governance*

Dodd-Frank requires publicly-traded companies to give stockholders a non-binding vote on executive compensation at least every three years, a non-binding vote regarding the frequency of the vote on executive compensation at least every six years, and a non-binding vote on "golden parachute" payments in connection with approvals of mergers and acquisitions unless previously voted on by stockholders. The SEC has finalized the rules implementing these requirements which took effect on January 21, 2011. Additionally, Dodd-Frank directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of \$1.0 billion, regardless of whether the company is publicly traded. Dodd-Frank also gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

*Prohibition Against Charter Conversions of Troubled Institutions*

Effective one year after enactment, Dodd-Frank prohibits a depository institution from converting from a state to a federal charter, or vice versa, while it is the subject of a cease and desist order or other formal enforcement action or a memorandum of understanding with respect to a significant supervisory matter unless the appropriate federal banking agency gives notice of the conversion to the federal or state authority that issued the enforcement action and that agency does not object within 30 days. The notice must include a plan to address the significant supervisory matter. The converting institution must also file a copy of the conversion application with its current federal regulator, which must notify the resulting federal regulator of any ongoing supervisory or investigative proceedings that are likely to result in an enforcement action and provide access to all supervisory and investigative information relating thereto.

*Interstate Branching*

Dodd-Frank authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks will be able to enter new markets more freely.

*Limits on Interstate Acquisitions and Mergers*

Dodd-Frank precludes a bank holding company from engaging in an interstate acquisition the acquisition of a bank outside its home state unless the bank holding company is both well capitalized and well managed. Furthermore, a bank may not engage in an interstate merger with another bank headquartered in another state unless the surviving institution will be well capitalized and well managed. The previous standard in both cases was adequately capitalized and adequately managed.

*Limits on Interchange Fees*

Dodd-Frank amends the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over \$10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

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*Consumer Financial Protection Bureau*

Dodd-Frank creates a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act, and certain other statutes. The CFPB will have examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB, but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower's ability to repay. In addition, Dodd-Frank will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

**FEDERAL DEPOSIT INSURANCE CORPORATION ACT OF 1991** Under the Federal Deposit Insurance Corporation Act of 1991, any depository institution, including the subsidiary bank, is prohibited from paying any dividends, making other distributions or paying any management fees if, after such payment, it would fail to satisfy the minimum capital requirement.

**FEDERAL RESERVE ACT** A subsidiary bank of a bank holding company is subject to certain restrictions and reporting requirements imposed by the Federal Reserve Act, including:

Extensions of credit to the bank holding company, its subsidiaries, or principal shareholders;

Investments in the stock or other securities of the bank holding company or its subsidiaries; and,

Taking such stock or securities as collateral for loans.

**COMMUNITY REINVESTMENT ACT OF 1977 (CRA)** Under the Community Reinvestment Act of 1977, the FDIC is required to assess the record of all financial institutions regulated by it to determine if these institutions are meeting the credit needs of the community, including low and moderate income neighborhoods, which they serve and to take this record into account in its evaluation of any application made by any of such institutions for, among other things, approval of a branch or other deposit facility, office relocation, merger, or acquisition of bank shares. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 amended the CRA to require, among other things, that the FDIC make publicly available the evaluation of a bank's record of meeting the credit needs of its entire community, including low and moderate income neighborhoods. This evaluation includes a descriptive rating like "outstanding", "satisfactory", "needs to improve" or "substantial noncompliance" and a statement describing the basis for the rating. These ratings are publicly disclosed.

**FEDERAL DEPOSIT INSURANCE CORPORATION IMPROVEMENT ACT OF 1991 (FDICIA)** The Federal Deposit Insurance Corporation Improvement Act requires that institutions be classified, based on their risk-based capital ratios into one of five defined categories, as illustrated

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below: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.

| <b>Capital Category</b>        | <b>Total Risk-<br/>Based<br/>Ratio</b> | <b>Tier 1<br/>Risk-<br/>Based<br/>Ratio</b> | <b>Tier 1<br/>Leverage<br/>Ratio</b> | <b>Under a<br/>Capital<br/>Order or<br/>Directive</b> |
|--------------------------------|--|---|--------------------------------------|---|
| Well capitalized               | ≥10.0%                                 | ≥6.0%                                       | ≥5.0%                                | NO  |
| Adequately capitalized         | ≥ 8.0%                                 | ≥4.0%                                       | ≥4.0%*                               |   |
| Undercapitalized               | < 8.0%                                 | <4.0%                                       | <4.0%*                               |   |
| Significantly undercapitalized | < 6.0%                                 | <3.0%                                       | <3.0%                                |   |
| Critically undercapitalized    |  |   | <2.0%                                |   |

\*

3.0% for those banks having the highest available regulatory rating.

In the event an institution's capital deteriorates to the undercapitalized category or below, FDICIA prescribes an increasing amount of regulatory intervention, including the institution of a capital restoration plan and a guarantee of the plan by a parent institution and the placement of a hold on increases in assets, number of branches, or lines of business. If capital reaches the significantly or critically undercapitalized levels, further material restrictions can be imposed, including restrictions on interest payable on accounts, dismissal of management, and, in critically undercapitalized situations, appointment of a receiver. For well capitalized institutions, FDICIA provides authority for regulatory intervention where the institution is deemed to be engaging in unsafe or unsound practices or receives a less than satisfactory examination report rating for asset quality, management, earnings or liquidity. All but well capitalized institutions are prohibited from accepting brokered deposits without prior regulatory approval. Under FDICIA, financial institutions are subject to increased regulatory scrutiny and must comply with certain operational, managerial and compensation standards developed by Federal Reserve Board regulations.

**FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) INSURANCE ASSESSMENTS** The subsidiary bank is subject to deposit insurance assessments by the FDIC. The assessments are based on the risk classification of the depository institution. The subsidiary bank was required to pay regular FDIC insurance assessments in 2009 of \$1,743,000 and a special assessment on September 30, 2009, of \$437,000. Furthermore, on December 31, 2009, all insured institutions were required to prepay 3.25 years of regular quarterly premiums. Each institution recorded the entire amount of its prepaid assessment as a prepaid expense (an asset). ACNB recorded its prepaid assessment in the amount of \$3,596,000 as a prepaid expense included in other assets as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, each institution records an expense, as a charge to earnings, for its regular quarterly assessment for the quarter and an offsetting credit to the prepaid assessment until the asset is exhausted. Once the asset is exhausted, the institution records an accrued expense payable each quarter for the assessment payment, which is paid in arrears to the FDIC at the end of the following quarter. If the prepaid assessment is not exhausted by December 30, 2014, any remaining amount will be returned to the depository institution. The FDIC also has adopted a uniform three basis point increase in assessment rates effective January 1, 2011.

**FASB PROPOSALS** On May 26, 2010, the Financial Accounting Standards Board (FASB) issued an exposure draft that proposes to dramatically overhaul financial instrument accounting. The changes would affect how banks account for a wide range of financial instruments, including investments in debt and equity securities, loans, deposits and borrowings. The proposed requirements affect the classification and measurement of financial instruments and the recognition and measurement of impairment losses on financial assets. Financial asset categories would be reduced to two categories: (1) fair value through net income and (2) fair value through other comprehensive income (OCI).

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Financial liabilities would be reduced to four categories: (1) fair value through net income, (2) fair value through OCI, (3) amortized cost and (4) remeasurement value (for core deposit liabilities). Principally all financial assets and most financial liabilities would be measured at fair value on the balance sheet. Further, some financial assets and liabilities would display both amortized cost and fair value amounts on the face of the balance sheet. Loans held to collect contractual cash flows are an example. A separate companion exposure draft proposes to require companies to display net income and OCI on one single statement of comprehensive income. As a result, the income statement would become the statement of comprehensive income (SCI). Comprehensive income is defined as net income plus OCI. Currently, OCI items bypass net income and are recorded as a separate component of equity in the balance sheet. The effective date for this proposal has not been set. The comment period for the exposure draft ended on September 30, 2010.

At the December 21, 2010 meeting, FASB decided that both the characteristics of the financial asset and an entity's business strategy should be used as criteria in determining the classification and measurement of financial assets. At this meeting, the FASB also tentatively decided to consider three categories for financial assets:

- (1) Fair Value Net Income (FV-NI), fair value measurement with all changes in fair value recognized in net income;
- (2) Fair Value Other Comprehensive Income (FV-OCI), fair value measurement with qualifying changes in fair value recognized in other comprehensive income; and,
- (3) Amortized cost.

Further, FASB discussed the business strategy criterion to determine which financial assets would be measured at amortized cost. FASB decided that a business activity approach should be used and that financial assets that an entity manages for the collection of contractual cash flows through a lending or customer financing activity should be measured at amortized cost.

FASB also decided that, for all other business activities, financial assets should be measured at fair value. Lastly, FASB decided that financial assets for which an entity's business activity is trading or holding for sale should be classified in the FV-NI category and that financial assets for which an entity's business activity is investing with a focus on managing risk exposures and maximizing total return should be classified in the FV-OCI category.

ACNB believes that the proposal does not reflect the business cycle of a community bank; it would be implemented inconsistently; and, most importantly, it would negatively affect the ability to serve community bank customers. Loans held to collect contractual cash flows is the primary earning asset of a community bank. These loans are underwritten to the specific attributes of the local market and the specific local customers, which generally cannot be valued efficiently such as is the case with equity and debt securities and more homogeneous loans such as residential mortgages underwritten to be sold into a secondary market. Loans that cannot be valued easily generally will reflect a discount in such measurements. The expected result of the proposal could be a combination of fewer loans written to support local businesses, higher interest rates charged, and shorter fixed-rate terms offered.

*Dividends*

ACNB is a legal entity separate and distinct from its subsidiary bank. ACNB's revenues, on a parent company only basis, result almost entirely from dividends paid to the Corporation by its subsidiary bank. Federal and state laws regulate the payment of dividends by ACNB's subsidiary bank. Please refer to "Regulation of Bank" below.

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*Regulation of Bank*

The operations of the subsidiary bank are subject to statutes applicable to banks chartered under the banking laws of Pennsylvania, to state nonmember banks, and to banks whose deposits are insured by the FDIC. The subsidiary bank's operations are also subject to regulations of the Pennsylvania Department of Banking, Federal Reserve, and FDIC.

The Pennsylvania Department of Banking, which has primary supervisory authority over banks chartered in Pennsylvania, regularly examines banks in such areas as reserves, loans, investments, management practices, and other aspects of operations. These examinations are designed for the protection of the subsidiary bank's depositors rather than ACNB's stockholders. The subsidiary bank must file quarterly and annual reports to the Federal Financial Institutions Examinations Council, or FFIEC.

*Monetary and Fiscal Policy*

ACNB and its subsidiary bank are affected by the monetary and fiscal policies of government agencies, including the Federal Reserve and FDIC. Through open market securities transactions and changes in its discount rate and reserve requirements, the Board of Governors of the Federal Reserve exerts considerable influence over the cost and availability of funds for lending and investment. The nature of monetary and fiscal policies on future business and earnings of ACNB cannot be predicted at this time. From time to time, various federal and state legislation is proposed that could result in additional regulation of, and restrictions on, the business of ACNB and the subsidiary bank, or otherwise change the business environment. Management cannot predict whether any of this legislation will have a material effect on the business of ACNB.

**ACCOUNTING POLICY DISCLOSURE**

Disclosure of the Corporation's significant accounting policies is included in Note A to the consolidated financial statements. Some of these policies are particularly sensitive requiring significant judgments, estimates and assumptions to be made by management. Additional information is contained in Management's Discussion and Analysis for the most sensitive of these issues, including the provision and allowance for loan losses which is located in Note D to the consolidated financial statements.

Management, in determining the allowance for loan losses, makes significant estimates. Consideration is given to a variety of factors in establishing this estimate. In estimating the allowance for loan losses, management considers current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan review, financial and managerial strengths of borrowers, adequacy of collateral if collateral dependent or present value of future cash flows, and other relevant factors.

**STATISTICAL DISCLOSURES**

The following statistical disclosures are included in Management's Discussion and Analysis, Item 7 hereof, and are incorporated by reference in this Item 1:

Interest Rate Sensitivity Analysis

Interest Income and Expense, Volume and Rate Analysis

Investment Portfolio

Loan Maturity and Interest Rate Sensitivity

Loan Portfolio

Allocation of Allowance for Loan Losses





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Deposits

Short-Term Borrowings

**AVAILABLE INFORMATION**

The Corporation's reports, proxy statements, and other information are available for inspection and copying at the SEC Public Reference Room at 100 F Street, N.E., Washington, DC, 20549, at prescribed rates. The public may obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0330. The Corporation is an electronic filer with the Commission. The Commission maintains a website that contains reports, proxy and information statements, and other information regarding registrants that file electronically with the Commission. The address of the Commission's website is <http://www.sec.gov>.

Upon a shareholder's written request, a copy of the Corporation's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, as required to be filed with the SEC pursuant to Securities Exchange Act Rule 13a-1, may be obtained, without charge, from Lynda L. Glass, Executive Vice President, Secretary & Chief Governance Officer, ACNB Corporation, 16 Lincoln Square, P.O. Box 3129, Gettysburg, PA 17325, or visit our website at <http://www.acnb.com> and click on "ACNB Corporation Investor Relations".

**EMPLOYEES**

As of December 31, 2011, ACNB had 291 full-time equivalent employees. None of these employees are represented by a collective bargaining agreement, and ACNB believes it enjoys good relations with its personnel.

**ITEM 1A RISK FACTORS**

**ACNB IS SUBJECT TO INTEREST RATE RISK.**

ACNB's earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest-earning assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond ACNB's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the amount of interest ACNB receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (i) ACNB's ability to originate loans and obtain deposits, (ii) the fair value of ACNB's financial assets and liabilities, and (iii) the average duration of ACNB's mortgage-backed securities portfolio. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, ACNB's net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on ACNB's results of operations, any substantial, unexpected or prolonged change in market interest rates could have a material adverse effect on ACNB's financial condition and results of operations.

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**ACNB IS SUBJECT TO CREDIT RISK.**

As of December 31, 2011, approximately 45% of ACNB's loan portfolio consisted of commercial and industrial, construction, and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate loans or consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because ACNB's loan portfolio contains a significant number of commercial and industrial, construction, and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for loan losses, and an increase in loan charge-offs, all of which could have a material adverse effect on ACNB's financial condition and results of operations.

**ACNB'S ALLOWANCE FOR LOAN LOSSES MAY BE INSUFFICIENT.**

ACNB maintains an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of the following: industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions; and, unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires ACNB to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans, and other factors, both within and outside of ACNB's control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review ACNB's allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. Further, if charge-offs in future periods exceed the allowance for loan losses, ACNB will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on ACNB's financial condition and results of operations.

**COMPETITION FROM OTHER FINANCIAL INSTITUTIONS MAY ADVERSELY AFFECT ACNB'S PROFITABILITY.**

ACNB's banking subsidiary faces substantial competition in originating both commercial and consumer loans. This competition comes principally from other banks, credit unions, mortgage banking companies, and other lenders. Many of its competitors enjoy advantages, including greater financial resources with higher lending limits, wider geographic presence, more branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, and lower origination and operating costs. This competition could reduce the Corporation's net income by decreasing the number and size of loans that its banking subsidiary originates and the interest rates it may charge on these loans.

In attracting business and consumer deposits, its banking subsidiary faces substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of ACNB's competitors enjoy advantages, including greater financial resources, wider geographic presence, more aggressive marketing campaigns, better brand recognition, more branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, and lower origination

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and operating costs. These competitors may offer higher interest rates than ACNB, which could decrease the deposits that it attracts or require it to increase its rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect the subsidiary's ability to generate the funds necessary for lending operations. As a result, it may need to seek other sources of funds that may be more expensive to obtain and could increase its cost of funds.

ACNB's banking subsidiary also competes with nonbank providers of financial services, such as brokerage firms, consumer finance companies, credit unions, insurance agencies, and governmental organizations which may offer more favorable terms. Some of its nonbank competitors are not subject to the same extensive regulations that govern ACNB's banking operations. As a result, such nonbank competitors may have advantages over ACNB's banking subsidiary in providing certain products and services. This competition may reduce or limit ACNB's margins on banking services, reduce its market share, and adversely affect its earnings and financial condition.

**ACNB'S CONTROLS AND PROCEDURES MAY FAIL OR BE CIRCUMVENTED.**

Management regularly reviews and updates ACNB's internal controls, disclosure controls and procedures, as well as corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of ACNB's controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on ACNB's business, financial condition and results of operations.

**ACNB'S ABILITY TO PAY DIVIDENDS DEPENDS PRIMARILY ON DIVIDENDS FROM ITS BANKING SUBSIDIARY, WHICH IS SUBJECT TO REGULATORY LIMITS AND THE BANK'S PERFORMANCE.**

ACNB is a financial holding company and its operations are conducted by its subsidiaries. Its ability to pay dividends depends on its receipt of dividends from its subsidiaries. Dividend payments from its banking subsidiary are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by the various banking regulatory agencies. The ability of its subsidiaries to pay dividends is also subject to their profitability, financial condition, capital expenditures, and other cash flow requirements. There is no assurance that its subsidiaries will be able to pay dividends in the future or that ACNB will generate adequate cash flow to pay dividends in the future. ACNB's failure to pay dividends on its common stock could have a material adverse effect on the market price of its common stock.

**ACNB'S PROFITABILITY DEPENDS SIGNIFICANTLY ON ECONOMIC CONDITIONS IN THE COMMONWEALTH OF PENNSYLVANIA AND THE STATE OF MARYLAND.**

ACNB's success depends primarily on the general economic conditions of the Commonwealth of Pennsylvania, the State of Maryland, and the specific local markets in which ACNB operates. Unlike larger national or other regional banks that are more geographically diversified, ACNB provides banking and financial services to customers primarily in the southcentral Pennsylvania and northern Maryland region of the country. The local economic conditions in these areas have a significant impact on the demand for ACNB's products and services, as well as the ability of ACNB's customers to repay loans, the value of the collateral securing the loans, and the stability of ACNB's deposit funding sources. A significant decline in general economic conditions caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets, or other factors could impact these local economic conditions and, in turn, have a material adverse effect on ACNB's financial condition and results of operations.

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**NEW LINES OF BUSINESS OR NEW PRODUCTS AND SERVICES MAY SUBJECT ACNB TO ADDITIONAL RISKS.**

From time to time, ACNB may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, ACNB may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business and/or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of ACNB's system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business and new products or services could have a material adverse effect on ACNB's business, financial condition and results of operations.

**ACNB MAY NOT BE ABLE TO ATTRACT AND RETAIN SKILLED PEOPLE.**

ACNB's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by ACNB can be intense, and ACNB may not be able to hire people or to retain them. The unexpected loss of services of one or more of ACNB's key personnel could have a material adverse impact on ACNB's business because of their skills, knowledge of ACNB's market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel. ACNB currently has employment agreements, including covenants not to compete, with the following named executive officers: its President & Chief Executive Officer; Executive Vice President, Secretary & Chief Governance Officer; Executive Vice President, Treasurer & Chief Financial Officer; and, the President & Chief Executive Officer of RIG.

**ACNB IS SUBJECT TO CLAIMS AND LITIGATION PERTAINING TO FIDUCIARY RESPONSIBILITY.**

From time to time, customers make claims and take legal action pertaining to ACNB's performance of its fiduciary responsibilities. Whether customer claims and legal action related to ACNB's performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to ACNB, they may result in significant financial liability and/or adversely affect the market perception of ACNB and its products and services, as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on ACNB's business, which, in turn, could have a material adverse effect on ACNB's financial condition and results of operations.

**THE TRADING VOLUME IN ACNB'S COMMON STOCK IS LESS THAN THAT OF OTHER LARGER FINANCIAL SERVICES COMPANIES.**

ACNB's common stock trades on NASDAQ, and the trading volume in its common stock is less than that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of ACNB's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which ACNB has no control. Given the lower trading volume of ACNB's common stock, significant sales of ACNB's common stock, or the expectation of these sales, could cause ACNB's stock price to fall.

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**ACNB OPERATES IN A HIGHLY REGULATED ENVIRONMENT AND MAY BE ADVERSELY AFFECTED BY CHANGES IN FEDERAL, STATE AND LOCAL LAWS AND REGULATIONS.**

ACNB, primarily through its banking subsidiary, is subject to extensive regulation, supervision and/or examination by federal and state banking authorities. Any change in applicable regulations or federal, state or local legislation could have a substantial impact on ACNB and its operations. Additional legislation and regulations that could significantly affect ACNB's powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on its financial condition and results of operations. Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank and financial holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have a negative impact on ACNB's financial condition and results of operations.

Like other financial holding companies and financial institutions, ACNB must comply with significant anti-money laundering and anti-terrorism laws. Under these laws, ACNB is required, among other things, to enforce a customer identification program and file currency transaction and suspicious activity reports with the federal government. Government agencies have substantial discretion to impose significant monetary penalties on institutions which fail to comply with these laws or make required reports.

**THE SOUNDNESS OF OTHER FINANCIAL INSTITUTIONS MAY ADVERSELY AFFECT ACNB.**

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. ACNB has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose ACNB to credit risk in the event of a default by a counterparty or client. In addition, ACNB's credit risk may be exacerbated when the collateral held by ACNB cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to ACNB. Any such losses could have a material adverse effect on ACNB's financial condition and results of operations.

**MARKET VOLATILITY MAY HAVE MATERIALLY ADVERSE EFFECTS ON ACNB'S LIQUIDITY AND FINANCIAL CONDITION.**

The capital and credit markets have been experiencing extreme volatility and disruption. Over the last several years, in some cases, the markets have exerted downward pressure on stock prices, security prices, and credit capacity for certain issuers without regard to those issuers' underlying financial strength. If the market disruption and volatility returns, there can be no assurance that ACNB will not experience adverse effects, which may be material, on its liquidity, financial condition, and profitability.

**ACNB MAY NEED OR BE COMPELLED TO RAISE ADDITIONAL CAPITAL IN THE FUTURE WHICH COULD DILUTE SHAREHOLDERS OR BE UNAVAILABLE WHEN NEEDED OR AT UNFAVORABLE TERMS.**

ACNB's regulators or market conditions may require it to increase its capital levels. If ACNB raises capital through the issuance of additional shares of its common stock or other securities, it would likely dilute the ownership interests of current investors and would likely dilute the per share book value and earnings per share of its common stock. Furthermore, it may have an adverse impact on ACNB's stock price. New investors may also have rights, preferences and privileges senior to ACNB's current shareholders, which may adversely impact its current shareholders. ACNB's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside its

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control, and on its financial performance. Accordingly, ACNB cannot be assured of its ability to raise additional capital on terms and time frames acceptable to it or to raise additional capital at all. If ACNB cannot raise additional capital in sufficient amounts when needed, its ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect ACNB's operations, financial condition, and results of operations.

**ACNB'S FUTURE ACQUISITIONS COULD DILUTE SHAREHOLDER OWNERSHIP AND MAY CAUSE IT TO BECOME MORE SUSCEPTIBLE TO ADVERSE ECONOMIC EVENTS.**

ACNB may use its common stock to acquire other companies or make investments in banks and other complementary businesses in the future. ACNB may issue additional shares of common stock to pay for future acquisitions, which would dilute current investors' ownership interest in ACNB. Future business acquisitions could be material to ACNB, and the degree of success achieved in acquiring and integrating these businesses into ACNB could have a material effect on the value of ACNB's common stock. In addition, any acquisition could require it to use substantial cash or other liquid assets or to incur debt. In those events, ACNB could become more susceptible to economic downturns and competitive pressures.

**PENNSYLVANIA BUSINESS CORPORATION LAW AND VARIOUS ANTI-TAKEOVER PROVISIONS UNDER ACNB'S ARTICLES AND BYLAWS COULD IMPEDE THE TAKEOVER OF ACNB.**

Various Pennsylvania laws affecting business corporations may have the effect of discouraging offers to acquire ACNB, even if the acquisition would be advantageous to shareholders. In addition, ACNB has various anti-takeover measures in place under its articles of incorporation and bylaws, including a supermajority vote requirement for mergers, a staggered Board of Directors, and the absence of cumulative voting. Any one or more of these measures may impede the takeover of ACNB without the approval of the Board of Directors and may prevent shareholders from taking part in a transaction in which they could realize a premium over the current market price of ACNB common stock.

**IF ACNB CONCLUDES THAT THE DECLINE IN VALUE OF ANY OF ITS INVESTMENT SECURITIES IS AN OTHER-THAN-TEMPORARY IMPAIRMENT, ACNB IS REQUIRED TO WRITE DOWN THE VALUE OF THAT SECURITY THROUGH A CHARGE TO EARNINGS.**

ACNB reviews its investment securities portfolio at each quarter-end to determine whether the fair value is below the current carrying value. When the fair value of any of its investment securities has declined below its carrying value, ACNB is required to assess whether the decline is an other-than-temporary impairment. If ACNB determines that the decline is an other-than-temporary impairment, it is required to write down the value of that security through a charge to earnings for credit related impairment. Non-credit related reductions in the value of a security do not require a write down of the value through earnings. Changes in the expected cash flows related to the credit related piece of the investment of a security in ACNB's investment portfolio or a prolonged price decline may result in ACNB's conclusion in future periods that an impairment is other-than-temporary, which would require a charge to earnings to write down the security to fair value. Due to the complexity of the calculations and assumptions used in determining whether an asset has an impairment that is other-than-temporary, the impairment disclosed may not accurately reflect the actual impairment in the future.

**ACNB IS SUBJECT TO POTENTIAL IMPAIRMENT OF GOODWILL AND INTANGIBLES.**

RIG has certain long-lived assets including purchased intangible assets subject to amortization such as insurance books of business and associated goodwill assets, which are reviewed for impairment

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annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Goodwill, that has an indefinite useful life is evaluated for impairment annually and is evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired. That annual assessment date is December 31. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The goodwill impairment analysis is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. ACNB performs an annual evaluation to determine if there is goodwill impairment.

**ACNB IS SUBJECT TO ENVIRONMENTAL LIABILITY RISK ASSOCIATED WITH LENDING ACTIVITIES.**

A significant portion of ACNB's banking subsidiary loan portfolio is secured by real property. During the ordinary course of business, ACNB may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, ACNB may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require ACNB to incur substantial expense and may materially reduce the affected property's value or limit ACNB's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase ACNB's exposure to environmental liability. Although ACNB has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on ACNB's financial condition and results of operations.

**THE SEVERITY AND DURATION OF THE CURRENT RECESSION AND THE COMPOSITION OF THE BANKING SUBSIDIARY'S LOAN PORTFOLIO COULD IMPACT THE LEVEL OF LOAN CHARGE-OFFS AND THE PROVISION FOR LOAN LOSSES AND MAY AFFECT ACNB'S NET INCOME OR LOSS.**

Lending money is a substantial part of ACNB's business through its banking subsidiary. However, every loan that ACNB makes carries a certain risk of non-payment. ACNB cannot assure that its allowance for loan losses will be sufficient to absorb actual loan losses. ACNB also cannot assure that it will not experience significant losses in its loan portfolio that may require significant increases to the allowance for loan losses in the future.

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Although ACNB evaluates every loan that it makes against its underwriting criteria, ACNB may experience losses by reasons of factors beyond its control. Some of these factors include changes in market conditions affecting the value of real estate and unexpected problems affecting the creditworthiness of ACNB's borrowers.

ACNB determines the adequacy of its allowance for loan losses by considering various factors, including:

An analysis of the risk characteristics of various classifications of loans;

Previous loan loss experience;

Specific loans that would have loan loss potential;

Delinquency trends;

Estimated fair value of the underlying collateral;

Current economic conditions;

The views of ACNB's regulators;

Reports of internal auditors;

Reports of external auditors;

Reports of loan reviews conducted by independent organizations; and,

Geographic and industry loan concentration.

Local economic conditions could impact the loan portfolio of ACNB. For example, an increase in unemployment, a decrease in real estate values, or increases in interest rates, as well as other factors, could further weaken the economies of the communities ACNB serves. Weakness in the market areas served by ACNB could depress the Corporation's earnings and, consequently, its financial condition because:

Borrowers may not be able to repay their loans;

The value of the collateral securing ACNB's loans to borrowers may decline; and/or,

The quality of ACNB's loan portfolio may decline.

Although, based on the aforementioned procedures implemented by ACNB, management believes the current allowance for loan losses is adequate, ACNB may have to increase its provision for loan losses should local economic conditions deteriorate which could negatively impact its financial condition and results of operations.



**CHANGES IN REAL ESTATE VALUES MAY ADVERSELY IMPACT ACNB'S BANKING SUBSIDIARY LOANS THAT ARE SECURED BY REAL ESTATE.**

A significant portion of ACNB's banking subsidiary loan portfolio consists of residential and commercial mortgages, as well as consumer loans, secured by real estate. These properties are concentrated in Adams County, Pennsylvania. Real estate values and real estate markets generally are affected by, among other things, changes in national, regional or local economic conditions, fluctuations in interest rates, the availability of loans to potential purchasers, changes in the tax laws and other government statutes, regulations and policies, and acts of nature. If real estate prices decline, particularly in ACNB's market area, the value of the real estate collateral securing ACNB's loans could be reduced. This reduction in the value of the collateral could increase the number of non-performing loans and could have a material adverse impact on ACNB's financial conditions and results of operations.

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**ACNB'S INFORMATION SYSTEMS MAY EXPERIENCE AN INTERRUPTION OR BREACH IN SECURITY.**

ACNB relies heavily on communications and information systems to conduct its business. Any failure, interruption or breach in security of these systems could result in failures or disruptions in ACNB's customer relationship management, general ledger, deposit, loan and other systems. While ACNB has policies and procedures designed to prevent or limit the effect of the failure, interruption or security breach of its information systems, there can be no assurance that any such failures, interruptions or security breaches will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions or security breaches of ACNB's information systems could damage ACNB's reputation, result in a loss of customer business, subject ACNB to additional regulatory scrutiny, or expose ACNB to civil litigation and possible financial liability, any of which could have a material adverse effect on ACNB's financial condition and results of operations.

**ACNB CONTINUALLY ENCOUNTERS TECHNOLOGICAL CHANGE.**

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. ACNB's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in ACNB's operations. Many of ACNB's competitors have substantially greater resources to invest in technological improvements. ACNB may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on ACNB's business and, in turn, ACNB's financial condition and results of operations.

**FINANCIAL SERVICES COMPANIES DEPEND ON THE ACCURACY AND COMPLETENESS OF INFORMATION ABOUT CUSTOMERS AND COUNTERPARTIES.**

In deciding whether to extend credit or enter into other transactions, ACNB may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. ACNB may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on ACNB's business and, in turn, ACNB's financial condition and results of operations.

**CONSUMERS MAY DECIDE NOT TO USE BANKS TO COMPLETE THEIR FINANCIAL TRANSACTIONS.**

Technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds in brokerage accounts or mutual funds that would have historically been held as bank deposits. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation", could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on ACNB's financial condition and results of operations.

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**THE CURRENT ECONOMIC DOWNTURN MAY CONTINUE TO ADVERSELY AFFECT SECONDARY SOURCES OF LIQUIDITY.**

In addition to primary sources of liquidity in the form of deposits and principal and interest payments on outstanding loans and investments, ACNB maintains secondary sources that provide it with additional liquidity. These secondary sources include secured and unsecured borrowings from sources such as the Federal Reserve Bank, Federal Home Loan Bank of Pittsburgh, and third-party commercial banks. However, market liquidity conditions have been negatively impacted by disruptions in the capital markets and could, in the future, have a negative impact on ACNB's secondary sources of liquidity.

**SEVERE WEATHER, NATURAL DISASTERS, ACTS OF WAR OR TERRORISM, AND OTHER EXTERNAL EVENTS COULD SIGNIFICANTLY IMPACT ACNB'S BUSINESS.**

Severe weather, natural disasters, acts of war or terrorism, and other adverse external events could have a significant impact on ACNB's ability to conduct business. Such events could affect the stability of ACNB's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause ACNB to incur additional expenses. Severe weather or natural disasters, acts of war or terrorism, or other adverse external events may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on ACNB's business, which, in turn, could have a material adverse effect on ACNB's financial condition and results of operations.

**THE POTENTIAL RATING DOWNGRADE OF THE UNITED STATES GOVERNMENT MAY ADVERSELY AFFECT ACNB.**

In July 2011, certain rating agencies placed the United States government's long-term sovereign debt rating on their equivalent of negative watch and announced the possibility of a credit rating downgrade. The rating agencies, due to constraints related to the rating of the United States, also placed government-sponsored enterprises in which ACNB invests and receives lines of credit from on negative watch. A downgrade of the United States credit rating would trigger a similar downgrade in the credit rating of these government-sponsored enterprises. Furthermore, the credit rating of other entities, such as state and local governments, may be downgraded if the United States' credit rating is downgraded. The impact that these credit rating downgrades may have on the national and local economy and on ACNB's financial condition and results of operations is uncertain.

**ACNB'S BANKING SUBSIDIARY MAY BE REQUIRED TO PAY HIGHER FDIC INSURANCE PREMIUMS OR SPECIAL ASSESSMENTS WHICH MAY ADVERSELY AFFECT ITS EARNINGS.**

Poor economic conditions and the resulting bank failures have increased the costs of the FDIC and depleted its Deposit Insurance Fund. Additional bank failures may prompt the FDIC to increase its premiums above the recently increased levels or to issue special assessments. ACNB is generally unable to control the amount of premiums or special assessments that its banking subsidiary is required to pay for FDIC insurance. Any future changes in the calculation or assessment of FDIC insurance premiums may have a material adverse effect on ACNB's financial condition, results of operations, and ability to continue to pay dividends on common stock at the current rate or at all.

**ITEM 1B UNRESOLVED STAFF COMMENTS**

None.

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**ITEM 2 PROPERTIES**

ACNB Bank, in addition to its main office in Gettysburg, Adams County, Pennsylvania, had a retail banking office network of eighteen offices at December 31, 2011. All offices are located in Adams County with the exception of one office located in Cumberland County and four offices located in York County. There are also loan production offices situated in Franklin and York Counties, Pennsylvania. Offices at fifteen locations are owned, while six are leased. All real estate owned by the subsidiary bank is free and clear of encumbrances. RIG has two leased offices located in Carroll County and Montgomery County, Maryland.

**ITEM 3 LEGAL PROCEEDINGS**

As of December 31, 2011, there were no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which ACNB or its subsidiaries are a party or by which any of their property is the subject. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation or its subsidiaries by governmental authorities.

**ITEM 4 MINE SAFETY DISCLOSURES**

Not Applicable.

Table of Contents**PART II****ITEM 5 MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

ACNB Corporation's common stock began trading on NASDAQ under the symbol ACNB on December 20, 2010. At December 31, 2011 and 2010, there were 20,000,000 shares of common stock authorized, 6,008,409 and 5,990,943 shares issued, respectively, and 5,945,809 and 5,928,343 shares outstanding, respectively. As of December 31, 2011, ACNB had approximately 2,467 stockholders of record. At December 31, 2011 and 2010, there were 62,600 shares of treasury stock purchased by the Corporation through the common stock repurchase program approved in October 2008. There have been no shares purchased during the most recent quarter and 57,400 shares can still be purchased under the program. ACNB is restricted as to the amount of dividends that it can pay to stockholders by virtue of the restrictions on the banking subsidiary's ability to pay dividends to ACNB under the Pennsylvania Banking Code, the Federal Deposit Insurance Corporation Act, and the regulations of the FDIC. Please refer to Notes J and N of the consolidated financial statements.

On May 5, 2009, stockholders approved and ratified the ACNB Corporation 2009 Restricted Stock Plan, effective as of February 24, 2009, which awards shall not exceed, in the aggregate, 200,000 shares of common stock. As of December 31, 2011, there were no shares of common stock granted as restricted stock awards to either employees or directors.

On May 5, 2009, stockholders approved and adopted the amendment to the Articles of Incorporation of ACNB Corporation to authorize up to 20,000,000 shares of preferred stock, par value \$2.50 per share. As of December 31, 2011, there were no issued or outstanding shares of preferred stock.

On January 24, 2011, the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan was introduced for stockholders of record. This plan provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. As of December 31, 2011, there were 17,466 shares of common stock issued through the Dividend Reinvestment and Stock Purchase Plan.

There have been no unregistered sales of stock in 2011, 2010 or 2009.

The following table reflects the quarterly high and low prices of ACNB's common stock for the periods indicated and the cash dividends on the common stock for the periods indicated.

|                | Price Range<br>Per Share |          | Per Share<br>Dividend |
|----------------|--------------------------|----------|-----------------------|
|                | High                     | Low      |                       |
| <b>2011:</b>   |                          |          |                       |
| First Quarter  | \$ 16.50                 | \$ 15.00 | \$ 0.19               |
| Second Quarter | 16.50                    | 14.85    | 0.19                  |
| Third Quarter  | 15.99                    | 13.70    | 0.19                  |
| Fourth Quarter | 15.50                    | 13.34    | 0.19                  |
| <b>2010:</b>   |                          |          |                       |
| First Quarter  | \$ 13.30                 | \$ 11.85 | \$ 0.19               |
| Second Quarter | 14.70                    | 12.80    | 0.19                  |
| Third Quarter  | 15.10                    | 13.60    | 0.19                  |
| Fourth Quarter | 16.00                    | 14.01    | 0.19                  |

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| Index                           | Period Ending |          |          |          |          |          |
|---------------------------------|---------------|----------|----------|----------|----------|----------|
|                                 | 12/31/06      | 12/31/07 | 12/31/08 | 12/31/09 | 12/31/10 | 12/31/11 |
| ACNB Corporation                | 100.00        | 83.64    | 71.88    | 80.08    | 102.35   | 94.97    |
| NASDAQ Composite                | 100.00        | 110.66   | 66.42    | 96.54    | 114.06   | 113.16   |
| Mid-Atlantic Custom Peer Group* | 100.00        | 91.11    | 72.66    | 72.66    | 73.57    | 73.91    |

\*

*Mid-Atlantic Custom Peer Group consists of Mid-Atlantic commercial banks with assets less than \$1B as of December 31, 2011, and indicated below. Source: SNL Financial LC, Charlottesville, VA*

| Company                               | City             | State | Company  | City          | State |
|---------------------------------------|------------------|-------|--|---------------|-------|
| 1st Colonial Bancorp, Inc.            | Collingswood     | NJ    | CB Financial Services, Inc.                          | Carmichaels   | PA    |
| 1st Constitution Bancorp              | Cranbury         | NJ    | CBT Financial Corporation                            | Clearfield    | PA    |
| 1st Summit Bancorp of Johnstown, Inc. | Johnstown        | PA    | CCFNB Bancorp, Inc.                                  | Bloomsburg    | PA    |
| Absecon Bancorp                       | Absecon          | NJ    | Cecil Bancorp, Inc.                                  | Elkton        | MD    |
| Adirondack Trust Company              | Saratoga Springs | NY    | Chesapeake Bancorp                                   | Chestertown   | MD    |
| Allegheny Valley Bancorp, Inc.        | Pittsburgh       | PA    | Citizens Financial Services, Inc.                    | Mansfield     | PA    |
| American Bank Incorporated            | Allentown        | PA    | Citizens National Bank of Meyersdale                 | Meyersdale    | PA    |
| AmeriServ Financial, Inc.             | Johnstown        | PA    | Clarion County Community Bank                        | Clarion       | PA    |
| Annapolis Bancorp, Inc.               | Annapolis        | MD    | CommerceFirst Bancorp, Inc.                          | Annapolis     | MD    |
| Apollo Bancorp, Inc.                  | Apollo           | PA    | Commercial National Financial Corporation            | Latrobe       | PA    |
| Ballston Spa Bancorp, Inc.            | Ballston Spa     | NY    | Community Bank of Bergen County                      | Maywood       | NJ    |
| Bancorp of New Jersey, Inc.           | Fort Lee         | NJ    | Community Bankers' Corporation                       | Indiana       | PA    |
| Bank of Akron                         | Akron            | NY    | Community First Bancorp, Inc.                        | Reynoldsville | PA    |
| Bank of Utica                         | Utica            | NY    | Community First Bank                                 | Somerseset    | NJ    |
| BCSB Bancorp, Inc.                    | Baltimore        | MD    | Community National Bank                              | Great Neck    | NY    |
|                                       |                  |       | Community National Bank of Northwestern Pennsylvania |               |       |
| Berkshire Bancorp Inc.                | New York         | NY    |  | Albion        | PA    |

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|                                   |               |    |                                    |              |    |
|-----------------------------------|---------------|----|------------------------------------|--------------|----|
| Brunswick Bancorp                 | New Brunswick | NJ | Community Partners Bancorp         | Middletown   | NJ |
| Calvin B. Taylor Bankshares, Inc. | Berlin        | MD | Cornerstone Financial Corp.        | Mount Laurel | NJ |
| Capital Bank of New Jersey        | Vineland      | NJ | Country Bank Holding Company, Inc. | New York     | NY |
| Carrollton Bancorp                | Columbia      | MD | County First Bank                  | La Plata     | MD |
| Damascus Community Bank           | Damascus      | MD | Lyons Bancorp, Inc.                | Lyons        | NY |

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| <b>Company</b>                            | <b>City</b>    | <b>State</b> | <b>Company</b>                          | <b>City</b>    | <b>State</b> |
|---|----------------|--------------|---|----------------|--------------|
| Delaware Bancshares, Inc.                 | Walton         | NY           | Madison National Bancorp Inc.           | Hauppauge      | NY           |
| Delhi Bank Corp.                          | Delhi          | NY           | Mainline Bancorp, Inc.                  | Ebensburg      | PA           |
| Delmar Bancorp                            | Salisbury      | MD           | Manor Bank                              | Manor          | PA           |
| Dimeco, Inc.                              | Honesdale      | PA           | Mars National Bank                      | Mars           | PA           |
| DNB Financial Corporation                 | Downingtown    | PA           | Mauch Chunk Trust Financial Corp.       | Jim Thorpe     | PA           |
| Eagle National Bancorp, Inc.              | Upper Darby    | PA           | Mid Penn Bancorp, Inc.                  | Millersburg    | PA           |
| Easton Bancorp, Inc.                      | Easton         | MD           | Mifflinburg Bank & Trust Company        | Mifflinburg    | PA           |
| Elmer Bancorp, Inc.                       | Elmer          | NJ           | MNB Corporation                         | Bangor         | PA           |
| Embassy Bancorp, Inc.                     | Bethlehem      | PA           | Muncy Bank Financial, Inc.              | Muncy          | PA           |
| Emclair Financial Corp.                   | Emlenton       | PA           | National Bank of Coxsackie              | Coxsackie      | NY           |
| Empire National Bank                      | Islandia       | NY           | National Capital Bank of Washington     | Washington     | DC           |
| ENB Financial Corp                        | Ephrata        | PA           | Neffs Bancorp, Inc.                     | Neffs          | PA           |
| Enterprise Financial Services Group, Inc  | Allison Park   | PA           | New Jersey Community Bank               | Freehold       | NJ           |
| Enterprise National Bank N.J.             | Kenilworth     | NJ           | New Millennium Bank                     | New Brunswick  | NJ           |
| ES Bancshares, Inc.                       | Newburgh       | NY           | New Tripoli Bancorp, Inc.               | New Tripoli    | PA           |
| Evans Bancorp, Inc.                       | Hamburg        | NY           | New Windsor Bancorp, Inc.               | New Windsor    | MD           |
| Farmers and Merchants Bank                | Upperco        | MD           | Northumberland Bancorp                  | Northumberland | PA           |
| Fidelity D & D Bancorp, Inc.              | Dunmore        | PA           | Norwood Financial Corp.                 | Honesdale      | PA           |
| First Bank                                | Hamilton       | NJ           | Old Line Bancshares, Inc.               | Bowie          | MD           |
| First Bank of Delaware                    | Wilmington     | DE           | Orange County Bancorp, Inc.             | Middletown     | NY           |
| First Community Financial Corporation     | Mifflintown    | PA           | Parke Bancorp, Inc.                     | Sewell         | NJ           |
| First Keystone Corporation                | Berwick        | PA           | Pascack Bancorp, Inc.                   | Westwood       | NJ           |
| First National Bank of Groton             | Groton         | NY           | Patapsco Bancorp, Inc.                  | Dundalk        | MD           |
| First Resource Bank                       | Exton          | PA           | Penn Bancshares, Inc.                   | Pennsville     | NJ           |
| Fleetwood Bank Corporation                | Fleetwood      | PA           | Penns Woods Bancorp, Inc.               | Williamsport   | PA           |
| FNB Bancorp, Inc.                         | Newtown        | PA           | Penskeco Financial Services Corporation | Scranton       | PA           |
| FNBM Financial Corporation                | Minersville    | PA           | Peoples Bancorp, Inc.                   | Chestertown    | MD           |
| FNBPA Bancorp, Inc.                       | Port Allegany  | PA           | Peoples Financial Services Corp.        | Hallstead      | PA           |
| Franklin Financial Services Corporation   | Chambersburg   | PA           | Peoples Limited                         | Wyalusing      | PA           |
| Frederick County Bancorp, Inc.            | Frederick      | MD           | PSB Holding Corporation                 | Preston        | MD           |
| Glen Burnie Bancorp                       | Glen Burnie    | MD           | Putnam County National Bank of Carmel   | Carmel         | NY           |
| Glenville Bank Holding Company, Inc.      | Scotia         | NY           | QNB Corp.                               | Quakertown     | PA           |
| GNB Financial Services, Inc.              | Gratz          | PA           | Regal Bancorp, Inc.                     | Owings Mills   | MD           |
| Gotham Bank of New York                   | New York       | NY           | Republic First Bancorp, Inc.            | Philadelphia   | PA           |
| Greater Hudson Bank, National Association | Middletown     | NY           | Rising Sun Bancorp                      | Rising Sun     | MD           |
| Hamlin Bank and Trust Company             | Smethport      | PA           | Riverview Financial Corporation         | Halifax        | PA           |
| Harbor Bankshares Corporation             | Baltimore      | MD           | Royal Bancshares of Pennsylvania, Inc.  | Narberth       | PA           |
| Harford Bank                              | Aberdeen       | MD           | Rumson-Fair Haven Bank & Trust Co.      | Rumson         | NJ           |
| Harvest Community Bank                    | Pennsville     | NJ           | Scottdale Bank & Trust Company          | Scottdale      | PA           |
| Herald National Bank                      | New York       | NY           | Shore Community Bank                    | Toms River     | NJ           |
| Highlands Bancorp, Inc.                   | Vernon         | NJ           | Solvay Bank Corporation                 | Solvay         | NY           |
| Hilltop Community Bancorp, Inc.           | Summit         | NJ           | Somerset Hills Bancorp                  | Bernardsville  | NJ           |
| Honat Bancorp, Inc.                       | Honesdale      | PA           | Somerset Trust Holding Company          | Somerset       | PA           |
| Hopewell Valley Community Bank            | Pennington     | NJ           | Steuben Trust Corporation               | Hornell        | NY           |
| Howard Bancorp, Inc.                      | Ellicott City  | MD           | Stewardship Financial Corporation       | Midland Park   | NJ           |
| IBW Financial Corporation                 | Washington     | DC           | Sussex Bancorp                          | Franklin       | NJ           |
| Jeffersonville Bancorp                    | Jeffersonville | NY           | Tri-County Financial Corporation        | Waldorf        | MD           |
| Jonestown Bank and Trust Co.              | Jonestown      | PA           | Turbotville National Bancorp, Inc.      | Turbotville    | PA           |
| JTNB Bancorp, Inc.                        | Jim Thorpe     | PA           | UNB Corporation                         | Mount Carmel   | PA           |
| Juniata Valley Financial Corp.            | Mifflintown    | PA           | Union Bancorp, Inc.                     | Pottsville     | PA           |
| Kinderhook Bank Corporation               | Kinderhook     | NY           | Unity Bancorp, Inc.                     | Clinton        | NJ           |
| Kish Bancorp, Inc.                        | Reedsville     | PA           | USB Bancorp, Inc.                       | Staten Island  | NY           |
| Landmark Bancorp, Inc.                    | Pittston       | PA           | West Milton Bancorp, Inc.               | West Milton    | PA           |
| Liberty Bell Bank                         | Marlton        | NJ           | Woodlands Financial Service Company     | Williamsport   | PA           |
| Luzerne National Bank Corporation         | Luzerne        | PA           |   |                |              |



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| Dollars in thousands, except per share data         | For the Year Ended December 31, |            |            |            |            |
|---|---------------------------------|------------|------------|------------|------------|
|   | 2011                            | 2010       | 2009       | 2008       | 2007       |
| <b>INCOME STATEMENT DATA</b>                        |                                 |            |            |            |            |
| Interest income                                     | \$ 41,832                       | \$ 44,640  | \$ 45,812  | \$ 47,921  | \$ 51,581  |
| Interest expense                                    | 7,462                           | 9,623      | 13,560     | 18,897     | 26,561     |
| Net interest income                                 | 34,370                          | 35,017     | 32,252     | 29,024     | 25,020     |
| Provision for loan losses                           | 5,435                           | 6,410      | 4,750      | 5,570      | 500        |
| Net interest income after provision for loan losses | 28,935                          | 28,607     | 27,502     | 23,454     | 24,520     |
| Other income  | 11,737                          | 12,172     | 11,703     | 10,438     | 10,364     |
| Other expenses                                      | 30,016                          | 30,303     | 30,629     | 26,071     | 25,030     |
| Income before income taxes                          | 10,656                          | 10,476     | 8,576      | 7,821      | 9,854      |
| Applicable income taxes                             | 2,154                           | 2,057      | 1,357      | 1,077      | 1,917      |
| Net income  | \$ 8,502                        | \$ 8,419   | \$ 7,219   | \$ 6,744   | \$ 7,937   |
| <b>BALANCE SHEET DATA (AT YEAR-END)</b>             |                                 |            |            |            |            |
| Assets  | \$ 1,004,823                    | \$ 968,667 | \$ 961,904 | \$ 976,679 | \$ 926,665 |
| Securities  | 219,259                         | 200,774    | 219,929    | 252,536    | 290,496    |
| Loans, net  | 678,986                         | 650,039    | 632,706    | 630,330    | 542,354    |
| Deposits  | 782,795                         | 746,526    | 728,523    | 690,297    | 670,640    |
| Borrowings  | 117,153                         | 120,585    | 135,585    | 190,404    | 161,012    |
| Stockholders' equity                                | 97,474                          | 93,754     | 88,303     | 84,439     | 85,130     |
| <b>COMMON SHARE DATA *</b>                          |                                 |            |            |            |            |
| Earnings per share basic                            | \$ 1.43                         | \$ 1.42    | \$ 1.22    | \$ 1.13    | \$ 1.32    |
| Cash dividends paid                                 | 0.76                            | 0.76       | 0.76       | 0.76       | 0.76       |
| Book value per share                                | 16.39                           | 15.81      | 14.90      | 14.18      | 14.21      |
| Weighted average number of common shares            | 5,936,030                       | 5,928,343  | 5,936,001  | 5,988,525  | 5,990,943  |
| Dividend payout ratio                               | 53.15%                          | 53.52%     | 62.50%     | 67.47%     | 57.52%     |
| <b>PROFITABILITY RATIOS AND CONDITION</b>           |                                 |            |            |            |            |
| Return on average assets                            | 0.85%                           | 0.86%      | 0.75%      | 0.72%      | 0.81%      |
| Return on average equity                            | 8.80%                           | 9.15%      | 8.34%      | 7.96%      | 9.83%      |
| Average stockholders' equity to average assets      | 9.72%                           | 9.40%      | 8.99%      | 9.10%      | 8.23%      |
| <b>SELECTED ASSET QUALITY RATIOS</b>                |                                 |            |            |            |            |
| Non-performing loans to total loans                 | 2.02%                           | 2.35%      | 2.39%      | 1.52%      | 0.41%      |
| Net charge-offs to average loans outstanding        | 0.77%                           | 0.47%      | 0.03%      | 0.68%      | 0.00%      |
| Allowance for loan losses to total loans            | 2.23%                           | 2.29%      | 1.86%      | 1.16%      | 1.07%      |
| Allowance for loan losses to non-performing loans   | 110.29%                         | 97.43%     | 77.72%     | 76.33%     | 258.99%    |

\*

All amounts restated for the 5% common stock dividend distributed in December 2006 and 2007.

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**ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**INTRODUCTION**

The following is management's discussion and analysis of the significant changes in the financial condition, results of operations, capital resources, and liquidity presented in its accompanying consolidated financial statements for ACNB Corporation (the Corporation or ACNB), a financial holding company. Please read this discussion in conjunction with the consolidated financial statements and disclosures included herein. Current performance does not guarantee, assure or indicate similar performance in the future.

**CRITICAL ACCOUNTING POLICIES**

The accounting policies that the Corporation's management deems to be most important to the portrayal of its financial condition and results of operations, and that require management's most difficult, subjective or complex judgment, often result in the need to make estimates about the effect of such matters which are inherently uncertain. The following policies are deemed to be critical accounting policies by management:

The allowance for loan losses represents management's estimate of probable losses inherent in the loan portfolio. Management makes numerous assumptions, estimates and adjustments in determining an adequate allowance. The Corporation assesses the level of potential loss associated with its loan portfolio and provides for that exposure through an allowance for loan losses. The allowance is established through a provision for loan losses charged to earnings. The allowance is an estimate of the losses inherent in the loan portfolio as of the end of each reporting period. The Corporation assesses the adequacy of its allowance on a quarterly basis. The specific methodologies applied on a consistent basis are discussed in greater detail under the caption, Allowance for Loan Losses, in a subsequent section of this Management's Discussion and Analysis of Financial Condition and Results of Operations.

The evaluation of securities for other-than-temporary impairment requires a significant amount of judgment. In estimating other-than-temporary impairment losses, management considers various factors including the length of time the fair value has been below cost, the financial condition of the issuer, and the Corporation's intent to sell, or requirement to sell, the securities before recovery of its value. Declines in fair value that are determined to be other than temporary are charged against earnings.

Accounting Standards Codification (ASC) Topic 350, *Intangibles - Goodwill and Other*, requires that goodwill is not amortized to expense, but rather that it be tested for impairment at least annually. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. The Corporation did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of December 31, 2011. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur. Other acquired intangible assets with finite lives, such as customer lists, are required to be amortized over the estimated lives. These intangibles are generally amortized using the straight line method over estimated useful lives of ten years.

**EXECUTIVE OVERVIEW**

The primary source of the Corporation's revenues is net interest income derived from interest earned on loans and investments, less deposit and borrowing funding costs. Revenues are influenced by general economic factors, including market interest rates, the economy of the markets served, stock market conditions, as well as competitive forces within the markets.

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The Corporation's overall strategy is to increase loan growth in local markets, while maintaining a reasonable funding base by offering competitive deposit products and services. The year 2011 continued to be challenging for many financial institutions with high levels of problem assets, recession in the housing markets, lingering high unemployment, and slow uneven growth. ACNB continued to be profitable and well capitalized despite expenses elevated from the aftershocks of this epic challenge to the United States economy. Lower provision for loan losses, which is still quite high by historic levels, and continued careful spending resulted in increased net income to \$8,502,000, or \$1.43 per share, in 2011, compared to \$8,419,000, or \$1.42 per share, in 2010 and \$7,219,000, or \$1.22 per share, in 2009. Returns on average equity were 8.80%, 9.15% and 8.34% in 2011, 2010 and 2009, respectively.

Because funding costs were near practical floors, they could not be decreased at the same rate of earning assets decreases, therefore the Corporation's net interest margin decreased from 2010 on average to 3.74% in 2011, compared to 3.92% and 3.64% in 2010 and 2009, respectively. Net interest income was \$34,370,000 in 2011, as compared to \$35,017,000 in 2010 and \$32,252,000 in 2009.

Other income was \$11,737,000, \$12,172,000 and \$11,703,000 in 2011, 2010 and 2009, respectively. The largest source of other income is commissions from insurance sales from Russell Insurance Group, Inc. (RIG), which decreased by 3% in 2011 with the effects of lower premium insurance and reduced commercial insurance volume due to economic contractions. In 2011, a \$1,000 net gain was recognized on investments compared to net gains of \$72,000 in 2010 and \$17,000 in 2009. In 2009, the Corporation took an impairment charge of \$522,000 on two equity securities that were determined to be other-than-temporarily impaired; no impairment charges occurred in either 2010 or 2011. Income from fiduciary activities totaled \$1,396,000 for 2011, as compared to \$1,303,000 for 2010 and \$1,057,000 for 2009. Trust fiduciary income benefited from continued organic growth in average assets under administration and higher estate settlement fees. Service charges on deposit accounts was stable at \$2,418,000 for 2011, and revenue from ATM and debit card transactions increased 10% to \$1,236,000 due to higher volume.

Other expenses decreased to \$30,016,000, or by 1%, in 2011, as compared to \$30,303,000 in 2010. Other expenses totaled \$30,629,000 in 2009. The largest component of other expenses is salaries and employee benefits, which decreased 1% to \$17,138,000 in 2011 compared to \$17,318,000 in 2010, in part due to lower defined benefit pension plan expense. Compared to 2010, occupancy expense decreased 6% in 2011 due to less specific repairs, while equipment expense increased 5% from increased investment in and maintenance on technology assets. Professional services expenses decreased 18% due to strategic initiatives and the subsidiary bank charter conversion during 2010. FDIC and other regulatory expenses decreased by 28% in 2011. Significantly higher expense since 2009 was the result of a requirement of all FDIC-insured banks to restore the Deposit Insurance Fund due to the cost of protecting depositors' accounts at failed banks during the severe recession. A more thorough discussion of the Corporation's results of operations is included in the following pages.

**RESULTS OF OPERATIONS***Net Interest Income*

The primary source of ACNB's traditional banking revenue is net interest income, which represents the difference between interest income on earning assets and interest expense on liabilities used to fund those assets. Earning assets include loans, securities, and interest bearing deposits with banks. Interest bearing liabilities include deposits and borrowings.

Net interest income is affected by changes in interest rates, volume of interest bearing assets and liabilities, and the composition of those assets and liabilities. The "interest rate spread" and "net interest margin" are two common statistics related to changes in net interest income. The interest rate spread represents the difference between the yields earned on interest earning assets and the rates paid for interest bearing liabilities. The net interest margin is defined as the percentage of net interest

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income to average earning assets, which also considers the Corporation's net non-interest bearing funding sources, the largest of which are non-interest bearing demand deposits and stockholders' equity.

The following table includes average balances, rates, interest income and expense, interest rate spread, and net interest margin:

**Table 1 Average Balances, Rates and Interest Income and Expense**

| Dollars in thousands                              | 2011              |                  |              | 2010              |                  |              | 2009              |                  |              |
|---|-------------------|------------------|--------------|-------------------|------------------|--------------|-------------------|------------------|--------------|
|   | Average Balance   | Interest         | Yield/Rate   | Average Balance   | Interest         | Yield/Rate   | Average Balance   | Interest         | Yield/Rate   |
| <b>INTEREST EARNING ASSETS</b>                    |                   |                  |              |                   |                  |              |                   |                  |              |
| Loans   | \$ 674,897        | \$ 34,493        | 5.11%        | \$ 663,642        | \$ 36,043        | 5.43%        | \$ 646,819        | \$ 35,626        | 5.51%        |
| Taxable securities                                | 184,642           | 6,006            | 3.25%        | 176,758           | 7,181            | 4.06%        | 186,403           | 8,620            | 4.62%        |
| Tax-exempt securities                             | 33,681            | 1,252            | 3.72%        | 34,470            | 1,308            | 3.79%        | 39,061            | 1,488            | 3.81%        |
| <b>Total Securities</b>                           | <b>218,323</b>    | <b>7,258</b>     | <b>3.32%</b> | <b>211,228</b>    | <b>8,489</b>     | <b>4.02%</b> | <b>225,464</b>    | <b>10,108</b>    | <b>4.48%</b> |
| Other   | 26,826            | 81               | 0.30%        | 17,902            | 108              | 0.60%        | 13,829            | 78               | 0.56%        |
| <b>Total Interest Earning Assets</b>              | <b>920,046</b>    | <b>41,832</b>    | <b>4.55%</b> | <b>892,772</b>    | <b>44,640</b>    | <b>5.00%</b> | <b>886,112</b>    | <b>45,812</b>    | <b>5.17%</b> |
| Cash and due from banks                           | 13,556            |                  |              | 14,721            |                  |              | 14,771            |                  |              |
| Premises and equipment                            | 13,898            |                  |              | 14,324            |                  |              | 14,156            |                  |              |
| Other assets                                      | 62,301            |                  |              | 71,180            |                  |              | 57,393            |                  |              |
| Allowance for loan losses                         | (15,369)          |                  |              | (14,068)          |                  |              | (9,669)           |                  |              |
| <b>Total Assets</b>                               | <b>\$ 994,432</b> |                  |              | <b>\$ 978,929</b> |                  |              | <b>\$ 962,763</b> |                  |              |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>       |                   |                  |              |                   |                  |              |                   |                  |              |
| <b>INTEREST BEARING LIABILITIES</b>               |                   |                  |              |                   |                  |              |                   |                  |              |
| Interest bearing demand deposits                  | \$ 138,242        | \$ 115           | 0.08%        | \$ 128,835        | \$ 125           | 0.10%        | \$ 114,979        | \$ 139           | 0.12%        |
| Savings deposits                                  | 230,221           | 354              | 0.15%        | 214,812           | 445              | 0.21%        | 205,899           | 885              | 0.43%        |
| Time deposits                                     | 292,381           | 3,988            | 1.36%        | 304,891           | 5,653            | 1.85%        | 307,893           | 8,283            | 2.69%        |
| <b>Total Interest Bearing Deposits</b>            | <b>660,844</b>    | <b>4,457</b>     | <b>0.67%</b> | <b>648,538</b>    | <b>6,223</b>     | <b>0.96%</b> | <b>628,771</b>    | <b>9,307</b>     | <b>1.48%</b> |
| Short-term borrowings                             | 43,124            | 91               | 0.21%        | 42,849            | 119              | 0.28%        | 46,885            | 331              | 0.71%        |
| Long-term borrowings                              | 76,776            | 2,914            | 3.80%        | 85,385            | 3,281            | 3.84%        | 101,260           | 3,922            | 3.87%        |
| <b>Total Interest Bearing Liabilities</b>         | <b>780,744</b>    | <b>7,462</b>     | <b>0.96%</b> | <b>776,772</b>    | <b>9,623</b>     | <b>1.24%</b> | <b>776,916</b>    | <b>13,560</b>    | <b>1.75%</b> |
| Non-interest bearing demand deposits              | 109,070           |                  |              | 98,862            |                  |              | 87,503            |                  |              |
| Other liabilities                                 | 8,005             |                  |              | 11,321            |                  |              | 11,814            |                  |              |
| Stockholders' equity                              | 96,613            |                  |              | 91,974            |                  |              | 86,530            |                  |              |
| <b>Total Liabilities and Stockholders' Equity</b> | <b>\$ 994,432</b> |                  |              | <b>\$ 978,929</b> |                  |              | <b>\$ 962,763</b> |                  |              |
| <b>NET INTEREST INCOME</b>                        |                   | <b>\$ 34,370</b> |              |                   | <b>\$ 35,017</b> |              |                   | <b>\$ 32,252</b> |              |
| <b>INTEREST RATE SPREAD</b>                       |                   |                  | <b>3.59%</b> |                   |                  | <b>3.76%</b> |                   |                  | <b>3.42%</b> |
| <b>NET INTEREST MARGIN</b>                        |                   |                  | <b>3.74%</b> |                   |                  | <b>3.92%</b> |                   |                  | <b>3.64%</b> |

For yield calculation purposes, nonaccruing loans are included in average loan balances. Loan fees of \$48,000, \$52,000 and \$90,000 as of December 31, 2011, 2010 and 2009, respectively, are included in interest income. Yields on tax-exempt securities are not tax effected.

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Table 1 presents balance sheet items on a daily average basis, net interest income, interest rate spread, and net interest margin for the years ending December 31, 2011, 2010 and 2009. Table 2 analyzes the relative impact on net interest income for changes in the volume of interest earning assets and interest bearing liabilities and changes in rates earned and paid by the Corporation on such assets and liabilities.

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Net interest income totaled \$34,370,000 in 2011, as compared to \$35,017,000 in 2010 and \$32,252,000 in 2009. During 2011, net interest income decreased as a result of lower interest income exceeding lower funding cost due to the inability to lower deposit rates further after several years of continued record low rates and a one-time interest recovery on a large loan in 2010. In addition to this recovery, the increase in net interest income in 2010 was primarily related to a better mix of earning assets and market-driven lower rates on funding.

The net interest margin during 2011 was 3.74% compared to 3.92% during 2010. The margin decreased due to continued decreasing earning asset yields that exceeded decreasing funding costs from lower rates on new or renewed time deposits and lower market rates on savings products. The Federal Open Market Committee repeatedly decreased the federal funds rate from September 2007 to December 2008 and has maintained it at 0% to 0.25% since that time. In addition, the Federal Reserve Bank has embarked on various programs referred to as Quantitative Easing which, in effect, attempted to lower rates on longer term portions of the yield curve. These decreases allowed interest rate reductions on lower-cost transactional deposit products and higher-cost certificates of deposit; the result was a 0.28% decrease in funding costs in 2011. Overtaking the benefit of a lower cost of funds in 2011, however, was earning asset yield declines in the investment portfolio as new purchases were at lower rates, as well as declines in the loan portfolio from existing adjustable rate loans resetting at lower rates based on declines in index rates. The decreased earning asset yields in 2010 were partially offset by interest income of \$605,000 on full payoff of a loan that was in nonaccrual status in prior years. This one-time recovery increased earning asset yield and net interest margin by seven basis points (.07%) for the year ended December 31, 2010. Maintaining the net interest margin going forward will be challenged by the fact that substantial amounts of deposits are at practical rate floors, while loans and the investment securities portfolio will most likely continue to decrease in yields. The cost and availability of wholesale funding could also be affected by a variety of internal and external factors resulting from the creditworthiness of the Corporation and the credit providers.

Average earning assets were \$920,046,000 in 2011, an increase of 3.1% from the balance of \$892,772,000 in 2010, which was an increase from \$886,112,000 in 2009. Loan growth represented the largest increase in average assets in 2011, along with smaller increases in the investment portfolio and interest bearing deposits. Loan growth in 2010 was partially offset by decreases in the investment portfolio. Average interest bearing liabilities were \$780,774,000 in 2011, up from \$776,772,000 in 2010 after a slight decrease from \$776,916,000 in 2009. Average non-interest bearing demand deposits increased 10.3%, continuing the trend upward for 2010 and 2009. This increase was attributed to new relationships and the value placed on FDIC insurance by depositors. On average, deposits (including non-interest bearing) were up 3.0%, while borrowings decreased by 6.5% as a result of funds available from deposit increases. Lower-cost transaction and savings deposits grew while time deposits decreased in 2011, continuing a trend started in 2008. This trend is attributed to depositors favoring liquidity in a generally low rate environment.

The rate/volume analysis detailed in Table 2 shows that the decrease in net interest income in 2011 was due to earning asset rate decreases exceeding funding cost rate decreases. Earning asset yields declined due to new purchases at lower rates in the investment portfolio and declines in the loan portfolio from existing adjustable rate loans resetting at lower rates and new lower-rate originations replacing loan amortizations at higher rates. In 2011, the decrease in interest income was 30% higher than the decrease in interest expense. Interest expense decreased due to less time deposit and borrowed fund volume and rate decreases in all interest bearing liability categories. Favorable rate changes resulting in less interest expense in 2010, as compared to 2009, were only partially offset by decreased volume in securities assets and loan rate decreases from loans resetting or originated at lower rates in 2010.

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The following table shows changes in net interest income attributed to changes in rates and changes in average balances of interest earning assets and interest bearing liabilities:

**Table 2 Rate/Volume Analysis**

| In thousands                         | 2011 versus 2010  |                   |                   | 2010 versus 2009  |                   |                   |
|--------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
|                                      | Due to Changes in |                   |                   | Due to Changes in |                   |                   |
|                                      | Volume            | Rate              | Total             | Volume            | Rate              | Total             |
| <b>INTEREST EARNING ASSETS</b>       |                   |                   |                   |                   |                   |                   |
| Loans                                | \$ 603            | \$ (2,153)        | \$ (1,550)        | \$ 918            | \$ (501)          | \$ 417            |
| Taxable securities                   | 309               | (1,484)           | (1,175)           | (430)             | (1,009)           | (1,439)           |
| Tax-exempt securities                | (30)              | (26)              | (56)              | (174)             | (6)               | (180)             |
| Total Securities                     | 279               | (1,510)           | (1,231)           | (604)             | (1,015)           | (1,619)           |
| Other                                | 40                | (67)              | (27)              | 24                | 6                 | 30                |
| <b>Total</b>                         | <b>\$ 922</b>     | <b>\$ (3,730)</b> | <b>\$ (2,808)</b> | <b>\$ 338</b>     | <b>\$ (1,510)</b> | <b>\$ (1,172)</b> |
| <b>INTEREST BEARING LIABILITIES</b>  |                   |                   |                   |                   |                   |                   |
| Interest bearing demand deposits     | \$ 9              | \$ (19)           | \$ (10)           | \$ 15             | \$ (29)           | \$ (14)           |
| Savings deposits                     | 30                | (121)             | (91)              | 37                | (477)             | (440)             |
| Time deposits                        | (224)             | (1,441)           | (1,665)           | (80)              | (2,550)           | (2,630)           |
| Short-term borrowings                | 1                 | (29)              | (28)              | (26)              | (186)             | (212)             |
| Long-term borrowings                 | (327)             | (40)              | (367)             | (610)             | (31)              | (641)             |
| <b>Total</b>                         | <b>(511)</b>      | <b>(1,650)</b>    | <b>(2,161)</b>    | <b>(664)</b>      | <b>(3,273)</b>    | <b>(3,937)</b>    |
| <b>Change in Net Interest Income</b> | <b>\$ 1,433</b>   | <b>\$ (2,080)</b> | <b>\$ (647)</b>   | <b>\$ 1,002</b>   | <b>\$ 1,763</b>   | <b>\$ 2,765</b>   |

The net change attributable to the combination of rate and volume has been allocated on a consistent basis between volume and rate based on the absolute value of each. For yield calculation purposes, nonaccruing loans are included in average balances.

*Provision for Loan Losses*

The provision for loan losses charged against earnings was \$5,435,000 in 2011, as compared to \$6,410,000 in 2010 and \$4,750,000 in 2009. ACNB adjusts the provision for loan losses periodically as necessary to maintain the allowance at a level deemed to meet the risk characteristics of the loan portfolio.

For additional discussion of the provision and the loans associated therewith, please refer to the "Asset Quality" section of this Management's Discussion and Analysis.

*Other Income*

Other income was \$11,737,000 for the year-ended December 31, 2011, a \$435,000, or 4%, decrease from 2010. The largest source of other income is commissions from insurance sales from RIG, which decreased 3% to \$4,824,000. The decrease was due to lost customers in the economic downturn, increased competition and a soft (low premium) market. "Contingent" commissions were stable, after declining in 2010. The "contingent" or extra commission payments from insurance carriers are mostly received in the first quarter of each year, and the amount is at the discretion of various insurance carriers in accordance with applicable insurance regulations. Heightened competition is expected to continue in this business line and contingent commissions are not predictable.

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In 2011, investment gains of \$1,000 were recognized compared to gains of \$72,000 in 2010 and \$17,000 in 2009. The higher gains in 2010 and 2009 were to adjust the interest rate and credit risk composition of the portfolio by selling selected municipal securities, no sales were made in 2011. The Corporation holds equity investments in the common stock of two bank holding companies headquartered and operating in Pennsylvania. Decreased market prices for these stocks below the acquisition prices resulted in the Corporation taking an impairment charge of \$522,000 on these two equity securities during the third quarter of 2009. Based on market values in excess of the subsequent carrying values, additional impairment charges were not necessary in 2011 or 2010.

Income from fiduciary activities, which includes fees from both institutional and personal trust and asset management services and estate settlement services, totaled \$1,396,000 for the year-ended December 31, 2011, as compared to \$1,303,000 for 2010 and \$1,057,000 for 2009. At December 31, 2011, ACNB had total assets under administration of approximately \$135,000,000, down 11% from \$152,000,000 at the end of 2010 and \$138,000,000 at the end of 2009. The increase in income was in part the result of higher estate settlement income in 2011 which varies with specific activity.

Service charges on deposit accounts increased less than 1% to \$2,418,000 on varying customer actions. Further, certain government regulations and policies effective in 2010 and 2011 limited service charge increases and make future revenue levels uncertain. Revenue from ATM and debit card transactions increased 10% to \$1,236,000 due to higher volume. The increase resulted from consumer desire to use more electronic delivery channels; however government actions could result in rate controls on this activity in future years, the effect of which cannot be currently quantified. Fee income from sold mortgages decreased by \$222,000, or 47%, due to lower sold mortgage volume.

*Impairment Testing*

RIG has certain long-lived assets, including purchased intangible assets subject to amortization such as insurance books of business and associated goodwill assets, which are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Goodwill that has an indefinite useful life is evaluated for impairment annually and is evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired. That annual assessment date is December 31. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The goodwill impairment analysis is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value



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of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. ACNB performs an annual evaluation to determine if there is goodwill impairment. As noted above, commissions from insurance sales decreased 3% although RIG's stand alone net income increased by 50% in 2011 compared to 2010 boosted by expense savings and elimination of management fees to the holding company. As the testing for potential impairment involves methods that include both current and projected income amounts, the fair value increased at December 31, 2011, as compared to previous years' impairment testing results.

The results of the annual evaluations determined that there was no impairment of goodwill, including the testing at December 31, 2011. However, future declines in RIG's net income or changes in external market factors, including likely buyers that are assumed in impairment testing, may require an impairment charge to goodwill. A liability incurred at December 31, 2011, for contingent consideration owed on previous purchases of additional insurance books of business, did not unfavorably impact the fair value of RIG. The liability for further contingent consideration incurred was \$338,000 compared to a maximum aggregate liability of \$1,800,000 on two purchases that had a contingent consideration measurement date at December 31, 2011. The actual liability was lower than the potential maximum aggregate liability due to the uncertainties in retaining books of business in the current economic cycle. Should it be determined in a future period that the goodwill has been impaired, then a charge to earnings will be recorded in the period that such a determination is made.

*Other Expenses*

Other expenses decreased 1% to \$30,016,000 for the year ended December 31, 2011. The largest component of other expenses is salaries and employee benefits, which fell 1% to \$17,138,000 compared to \$17,318,000 in 2010. The reasons for the decrease in salaries and employee benefits expenses include the following:

decreased defined benefit pension expense due to prior year plan investment performance and the reduced benefit formula implemented by the Corporation on January 1, 2010,

stable other benefit plan costs, particularly medical insurance, and

lower production-based commissions and incentives, offset by

increases from higher employee usage of 401(k) plan benefits including the employer match and compliance cost, and payroll taxes,

normal merit increases to employees, and

an increase in the number of full-time equivalent employees.

Salaries and employee benefits decreased \$362,000 or 2% from 2009 to 2010. The decreased expense was due primarily to a significantly lower defined benefit pension expense in 2010 from better return on plan assets in 2009 after the severe downturn in return in 2008.

The Corporation reduced the benefit formula for the defined benefit pension plan effective January 1, 2010, in order to manage total benefit costs. The Corporation's overall investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation's risk tolerance on contribution levels, funded status, plan expense, as well as any applicable regulatory requirements. However, the determination of future benefit expense is also dependent on the fair value of assets and the discount rate on the year-end measurement date; specifically, with low discount rates and fair value volatility, the expense will be negatively impacted in 2012 by the historically low rates at the latest measurement date and very low plan return in 2011.

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Net occupancy expense was \$2,043,000 in 2011, \$2,197,000 in 2010, and \$2,281,000 in 2009. Equipment expense totaled \$2,620,000 during 2011, as compared to \$2,499,000 during 2010 and \$2,175,000 during 2009. Occupancy was lower in 2011 due to lower repair and real estate tax expenditures; equipment expenses increased in 2011 due to new technology purchases and the related maintenance. Equipment expenses are subject to ever increasing technology demands and the need for systems reliability in a digital age. The majority of the expense increase in 2010 from 2009 was a result of various technology upgrades.

Professional services expense totaled \$911,000 for 2011, as compared to \$1,116,000 for 2010 and \$860,000 for 2009. Increased expense in 2010 included legal expense associated with problem loans and a series of strategic initiatives that included converting the subsidiary bank to a state charter, listing ACNB Corporation on the NASDAQ Stock Market, and work on the Dividend Reinvestment and Stock Purchase Plan. Other tax expenses increased slightly in 2011 compared to 2010 due to an increased capital base at the Bank. Supplies and postage expenses decreased in 2011 compared to the two prior years due to customers' increased use of electronic transaction channels.

Marketing expenses increased 4% during 2011 due to expenses related to a new community office and various product promotions. In 2010, marketing expenses were higher than in 2009 due in part to communications regarding the subsidiary bank's change to a state charter.

FDIC and regulatory expense for 2011 was \$1,026,000, a decrease of \$408,000 from \$1,434,000 in 2010. FDIC and regulatory expense in 2009 was \$1,958,000. Part of the decrease was due to the subsidiary Bank's conversion to a state charter which resulted in continued rigorous state and federal examination processes, but at a lower cost. Despite the decrease in 2011 and 2010, FDIC expense for all years presented was much higher than periods before the severe financial crisis. The much higher expense was required of all FDIC-insured banks to restore the deposit insurance fund due to the cost of protecting depositors' accounts at failed banks during this recession. At the end of the third quarter of 2009, the FDIC announced a plan in which most banks prepaid 3.25 years of regular quarterly premiums at year-end 2009, as opposed to a special assessment similar to which was levied in the second quarter of 2009. The prepaid assessment did not immediately affect Bank earnings. Each institution recorded its prepaid assessment as a prepaid expense (an asset) as of December 30, 2009, the date the payment was made. At December 31, 2009, and each quarter thereafter, each institution records an expense for its regular quarterly assessment and an offsetting credit to the prepaid expense until the asset is exhausted. Once the asset is exhausted, the institution will record an accrued expense payable each quarter for the assessment payment, which will be made to the FDIC at the end of the following quarter. Even though an estimated premium is prepaid under this current plan, the actual expense will vary based on several factors including quarter-end deposit levels and risk ratings.

Foreclosed assets held for resale consists of the fair value of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. Foreclosed real estate expenses were \$725,000, \$292,000 and \$18,000 for years ended December 31, 2011, 2010 and 2009, respectively. The escalating cost was due to the increased number and varying mix of commercial and residential collateral, unpaid property taxes and deferred maintenance required upon acquisition. In addition, some properties suffered decreases in value after acquisition (requiring write-downs to fair value) during prolonged marketing cycles for these distressed properties. The 2011 expense was net of a \$194,000 gain on one commercial real estate participation loan in the first quarter. Foreclosed assets held for resale expenses are projected to remain high in 2012 due to the existing inventory of properties and projected additions based on information derived from the estimation process of the allowance for loan losses.

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Other operating expenses increased 5% in 2011 as a result of corporate governance, communications and loan promotion expenditures. Other operating expenses decreased 12% in 2010 from 2009 mainly as a result of cost savings in discretionary expenditures.

*Provision for Income Taxes*

ACNB recognized income taxes of \$2,154,000, or 20.2% of pretax income, during 2011, as compared to \$2,057,000, or 19.6%, during 2010 and \$1,357,000, or 15.8%, during 2009. The variances from the federal statutory rate are generally due to tax-exempt income (from investments in and loans to state and local units of government at below-market rates, an indirect form of taxation) and investments in low-income housing partnerships (which qualify for federal tax credits).

The increasing effective tax rate during 2011 and 2010 compared to 2009 was a result of increasing pretax income in relationship to stable tax-exempt income. Pretax income increased in 2011 and 2010 due to revenue and expense elements described above.

At December 31, 2011, net deferred tax assets amounted to \$1,447,000. Deferred tax assets are realizable primarily through future reversal of existing taxable temporary differences. Management currently anticipates future earnings and capital gains will be adequate to utilize deferred tax assets. Accordingly, no valuation allowance has been established for deferred tax assets at December 31, 2011.

**FINANCIAL CONDITION**

Average earning assets increased in 2011 to \$920,046,000, or by 3%, from \$892,772,000 in 2010 following \$886,112,000 in 2009. ACNB's investment portfolio increased in 2011 from strong deposit growth after it had decreased in 2010 and 2009 as a result of the planned objective to fund in-market loans and reduce average borrowings. Loans increased 2% and 3% on average in 2011 and 2010, respectively. Besides funds provided by investment pay-downs, growth in loans was funded by increased customer deposits. Average deposits increased in 2011 to \$769,914,000 from \$747,400,000 in 2010 and \$716,274,000 in 2009. Average borrowings decreased in 2011 to \$119,900,000 from \$128,234,000 in 2010 and \$148,145,000 in 2009.

*Investment Securities*

ACNB uses investment securities to generate interest and dividend income, manage interest rate risk, provide collateral for certain funding products, and provide liquidity. The increase in the securities portfolio in 2011 was mainly to deploy growth in deposits into available investments that combined the desired combination of yield, liquidity and manageable interest rate risk sensitivity. This process was made more challenging due to the Federal Reserve Bank's program commonly called Quantitative Easing in which, by their open market purchases, the yields are maintained at a lower level than would otherwise be the case. The contraction in the securities portfolio during 2010 was designed to fund increased lending in the earning asset mix, but was also a result of relatively low yields available on investments within the credit quality and interest rate sensitivity targets of ACNB. The investment portfolio is comprised of U.S. Government agency, municipal, and corporate securities. These securities provide the appropriate characteristics with respect to credit quality, yield and maturity relative to the management of the overall balance sheet.

At December 31, 2011, the securities balance included a net unrealized gain on available for sale securities of \$5,996,000, net of taxes, on amortized cost of \$200,144,000 versus a net unrealized gain of \$3,923,000, net of taxes, on amortized cost of \$184,787,000 at December 31, 2010. The increase in fair value of available for sale securities during 2011 was a result of a higher amount of investments in the portfolio and changes in the U.S. Treasury yield curve and the spread from this yield curve required by investors on the types of investment securities that ACNB owns. Actions by the Federal Reserve to lower rates on the yield curve most conducive to stimulating the housing market and separate concerns

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about European sovereign debt offset the bonds markets concern about the level of U.S. debt and inflation, leading to generally lower rates in the yield curve, however fair values were volatile on any given day in 2011. The Corporation does not own investments consisting of pools of Alt A or subprime mortgages, private label mortgage-backed securities, or trust preferred investments. The fair values of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1) or by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on securities' relationship to other benchmark quoted prices. The Corporation uses a trusted service provider to provide matrix pricing and uses the valuation of another provider to compare the pricing for reasonableness. The Corporation holds equity investments in the common stock of two bank holding companies headquartered and operating in Pennsylvania. Both holding companies continue to pay cash dividends, which was one of the driving forces in the initial investment decision. However, current market prices for these stocks are below the prices paid at the time of acquisition. A review of the factors that may be contributing to these price declines led to a conclusion that the prices on these securities were not likely to recover in the near term and that they were other-than-temporarily impaired. A charge against current earnings of \$522,000 was taken in the third quarter of 2009 to write-down the value of these securities. Please refer to Note C "Securities" in the Notes to Consolidated Financial Statements for more information on the security portfolio and Note L "Fair Value Measurements" in the Notes to Consolidated Financial Statements for more information about fair value.

The following tables set forth the composition of the securities portfolio and the securities maturity schedule, including weighted average yield, as of the end of the years indicated:

**Table 3 Investment Securities**

| In thousands   | 2011              | 2010       | 2009       |
|--|-------------------|------------|------------|
| <b>AVAILABLE FOR SALE SECURITIES AT FAIR VALUE</b>   |                   |            |            |
| U.S. Government and agencies                         | \$ 40,169         | \$ 28,260  | \$ 24,328  |
| Mortgage-backed securities                           | 107,527           | 114,359    | 133,497    |
| State and municipal                                  | 46,317            | 34,676     | 41,271     |
| Corporate bonds                                      | 13,379            | 11,659     | 10,174     |
| CRA mutual fund                                      | 1,081             | 1,030      |            |
| Stock in other banks                                 | 754               | 746        | 602        |
|  | <b>209,227</b>    | 190,730    | 209,872    |
| <b>HELD TO MATURITY SECURITIES AT AMORTIZED COST</b> |                   |            |            |
| U.S. Government and agencies                         | 10,032            | 10,044     | 10,057     |
|  | <b>10,032</b>     | 10,044     | 10,057     |
| <b>TOTAL</b>   | <b>\$ 219,259</b> | \$ 200,774 | \$ 219,929 |

Table 4 discloses investment securities at the scheduled maturity date at December 31, 2011. Many securities have call features that make their redemption possible before the stated maturity date.

Table of Contents**Table 4 Securities Maturity Schedule**

| Dollars in thousands         | 1 Year or Less |       | Over 1 - 5 Years |       | Over 5 - 10 Years |       | Over 10 Years or No Maturity |       | Total      |       |
|------------------------------|----------------|-------|------------------|-------|-------------------|-------|------------------------------|-------|------------|-------|
|                              | Amount         | Yield | Amount           | Yield | Amount            | Yield | Amount                       | Yield | Amount     | Yield |
| U.S. Government and agencies | \$             |       | % 39,139         | 2.90% | \$ 8,125          | 2.24% | \$ 2,005                     | 5.50% | \$ 49,269  | 2.90% |
| Mortgage-backed securities   |                |       |                  |       | 46,596            | 4.54  | 55,463                       | 3.80  | 102,059    | 4.14  |
| State and municipal          | 501            | 4.00  | 3,777            | 3.20  | 30,919            | 3.67  | 8,875                        | 3.77  | 44,072     | 3.65  |
| Corporate bonds              | 6,081          | 6.88  | 7,024            | 3.26  |                   |       |                              |       | 13,105     | 4.94  |
| CRA mutual fund              |                |       |                  |       |                   |       | 1,044                        |       | 1,044      |       |
| Stock in other banks         |                |       |                  |       |                   |       | 627                          |       | 627        |       |
|                              | \$ 6,582       | 6.66% | \$ 49,940        | 2.98% | \$ 85,640         | 4.01% | \$ 68,014                    | 3.76% | \$ 210,176 | 3.76% |

Securities are at amortized cost. Mortgage-backed securities are allocated based upon scheduled maturities.

*Loans*

Loans outstanding increased by \$29,177,000, or 4.4%, in 2011, as compared to 3% growth experienced in 2010, demonstrating the determined efforts to lend to creditworthy borrowers despite the continued difficult economic conditions. The higher growth was centered in increased commercial purpose loans (both real estate secured and non real estate secured) and in local market residential mortgages, in part offset by continued declines in commercial construction loans. The commercial purpose segments increased \$13,500,000 or 5%, during 2011; spread among diverse categories that include farmland secured, loans to local government units, and other types of commercial real estate secured lending. Residential real estate mortgage lending, which include smaller commercial purpose loans secured by the owner's home, increased by \$17,900,000 or 5%, to local borrowers who preferred loan types that would not be sold into the secondary mortgage market. Of the \$17,900,000 increase, \$1,400,000 was residential mortgage loans secured by junior liens or home equity loans, which are also in many cases junior liens. Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market continues to be weak and property values further deteriorate. Real estate construction loans continued to decline in 2011, down \$3,900,000 or 15%, as a result of the weak demand in the residential real estate market and because of stricter underwriting on this type due to the category's credit attributes.

The commercial loan increase was higher in 2010 compared to 2009 as the result of more concentrated efforts by a larger lending staff despite reduced business activity in the market area that hindered new originations, as well as management's decision to not renew certain commercial loans, primarily participation credits in conjunction with other financial institutions, due to perceived potential credit risk.

Table of Contents**Table 5 Loan Portfolio**

Loans at December 31 were as follows:

| In thousands                           | 2011              | 2010              | 2009              | 2008              | 2007              |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Commercial, financial and agricultural | \$ 56,145         | \$ 52,676         | \$ 45,947         | \$ 59,861         | \$ 62,844         |
| Real estate:                           |                   |                   |                   |                   |                   |
| Commercial                             | 236,017           | 225,950           | 209,054           | 173,926           | 127,465           |
| Construction                           | 22,757            | 26,635            | 37,966            | 48,958            | 38,370            |
| Residential                            | 363,798           | 345,854           | 337,342           | 341,916           | 310,459           |
| Consumer                               | 15,751            | 14,176            | 14,378            | 13,062            | 9,064             |
| <b>Total Loans</b>                     | <b>\$ 694,468</b> | <b>\$ 665,291</b> | <b>\$ 644,687</b> | <b>\$ 637,723</b> | <b>\$ 548,202</b> |

The repricing range of the loan portfolio and the amounts of loans with predetermined and fixed rates are presented in the table below:

**Table 6 Loan Sensitivities****LOANS MATURING**

| In thousands                           | Less than<br>1 Year | 1-5 Years         | Over<br>5 Years   | Total             |
|--|---------------------|-------------------|-------------------|-------------------|
| Commercial, financial and agricultural | \$ 24,379           | \$ 20,308         | \$ 11,458         | \$ 56,145         |
| Real estate:                           |                     |                   |                   |                   |
| Commercial                             | 60,753              | 139,022           | 36,242            | 236,017           |
| Construction                           | 15,353              | 6,528             | 876               | 22,757            |
| Residential                            | 74,620              | 89,272            | 199,906           | 363,798           |
| <b>Total</b>                           | <b>\$ 175,105</b>   | <b>\$ 255,130</b> | <b>\$ 248,482</b> | <b>\$ 678,717</b> |

**LOANS BY REPRICING OPPORTUNITY**

| In thousands                           | Less than<br>1 Year | 1-5 Years         | Over<br>5 Years   | Total             |
|--|---------------------|-------------------|-------------------|-------------------|
| Commercial, financial and agricultural | \$ 16,989           | \$ 21,328         | \$ 17,828         | \$ 56,145         |
| Real estate:                           |                     |                   |                   |                   |
| Commercial                             | 16,639              | 122,474           | 96,904            | 236,017           |
| Construction                           | 12,774              | 5,915             | 4,068             | 22,757            |
| Residential                            | 42,685              | 84,773            | 236,340           | 363,798           |
| <b>Total</b>                           | <b>\$ 89,087</b>    | <b>\$ 234,490</b> | <b>\$ 355,140</b> | <b>\$ 678,717</b> |
| Loans with a fixed interest rate       | \$ 39,082           | \$ 32,244         | \$ 220,537        | \$ 291,863        |
| Loans with a variable interest rate    | 50,005              | 202,246           | 134,603           | 386,854           |
| <b>Total</b>                           | <b>\$ 89,087</b>    | <b>\$ 234,490</b> | <b>\$ 355,140</b> | <b>\$ 678,717</b> |

Most of the Corporation's lending activities are with customers located within the southcentral Pennsylvania and in the northern Maryland area that is contiguous to its Pennsylvania retail banking offices. This region currently and historically has lower unemployment than the U.S. as a whole. Included in commercial real estate loans are loans made to lessors of non-residential dwellings that total \$99,700,000, or 14% of total loans, at December 31, 2011. These borrowers are geographically dispersed throughout ACNB's marketplace and are leasing commercial properties to a varied group of tenants including medical offices, retail space, and recreational facilities. Because of the varied nature



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of the tenants, in aggregate, management believes that these loans do not present any greater risk than commercial loans in general. ACNB does not originate or hold subprime mortgages in its loan portfolio.

The Bank has granted loans to certain of its executive officers, directors and their related interests. These loans were made on substantially the same basis, including interests rates and collateral as those prevailing for comparable transactions with other borrowers at the same time. The aggregate amount of these loans was \$10,318,000 and \$13,367,000 at December 31, 2011 and 2010, respectively. During 2011, \$1,939,000 of new loans and advances were extended and repayments totaled \$4,988,000. None of these loans were past due, in non-accrual status, or restructured at December 31, 2011.

*Asset Quality*

The ACNB loan portfolio is subject to varying degrees of credit risk. Credit risk is mitigated through prudent underwriting standards, ongoing credit review, and monitoring and reporting asset quality measures. Additionally, loan portfolio diversification, limiting exposure to a single industry or borrower, and requiring collateral also reduces ACNB's credit risk.

ACNB's commercial, consumer and residential mortgage loans are principally to borrowers in southcentral Pennsylvania and northern Maryland. As the majority of ACNB's loans are located in this area, a substantial portion of the debtor's ability to honor the obligation may be affected by the level of economic activity in the market area.

Although materially elevated from several years back, the unemployment rate in ACNB's market area remained below the state and national average during 2011. Additionally, low interest rates, a less volatile local economy, and minimal inflation continued to provide some support to the economic conditions in the area. During 2011, continued contraction in new residential real estate development/construction and general lower economic activity lingered from the recent major recession, challenging the Corporation's marketplace commercial activity. Slower growth areas such as ACNB's marketplace generally do not retract in economic recessions as quickly and as low as other areas of the country, however the recovery from low economic cycles are also generally slower.

Non-performing assets include nonaccrual and restructured loans (troubled debt restructures or TDRs), accruing loans past due 90 days or more, and other foreclosed assets. The accrual of interest on residential mortgage and commercial loans (consisting of commercial and industrial, commercial real estate, and commercial real estate construction loan classes) is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in the process of collection. Consumer loans (consisting of home equity lines of credit and consumer loan classes) are typically charged off no later than 120 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. ACNB occasionally returns nonaccrual loans to performing status when the borrower brings the loan current and performs in accordance with contractual terms for a reasonable period of time. ACNB categorizes a loan as a TDR if it changes the terms of the loan, such as interest rate, repayment schedule or both, to terms that it otherwise would not have granted to a borrower, for economic or legal reasons related to the borrower's financial difficulties. For all periods presented, TDRs were also nonaccrual loans.



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The following table sets forth the Corporation's non-performing assets as of the end of the years indicated:

**Table 7 Non-Performing Assets**

| Dollars in thousands               | 2011             | 2010      | 2009      | 2008      | 2007     |
|------------------------------------|------------------|-----------|-----------|-----------|----------|
| Nonaccrual loans, including TDRs   | \$ 12,846        | \$ 14,657 | \$ 13,308 | \$ 7,723  | \$ 854   |
| Accruing loans 90 days past due    | 1,191            | 997       | 2,107     | 1,963     | 1,404    |
| <b>Total Non-Performing Loans</b>  | <b>14,037</b>    | 15,654    | 15,415    | 9,686     | 2,258    |
| Foreclosed real estate             | 4,437            | 7,859     | 6,046     | 625       | 136      |
| <b>Total Non-Performing Assets</b> | <b>\$ 18,474</b> | \$ 23,513 | \$ 21,461 | \$ 10,311 | \$ 2,394 |

Ratios:

|   |         |        |        |        |         |
|---|---------|--------|--------|--------|---------|
| Non-performing loans to total loans               | 2.02%   | 2.35%  | 2.39%  | 1.52%  | 0.41%   |
| Non-performing assets to total assets             | 1.84%   | 2.43%  | 2.23%  | 1.06%  | 0.26%   |
| Allowance for loan losses to non-performing loans | 110.29% | 97.43% | 77.72% | 76.33% | 258.99% |

If interest due on all nonaccrual loans had been accrued at original contract rates, it is estimated that income before income taxes would have been greater by \$652,000 in 2011, \$464,000 in 2010, and \$643,000 in 2009. The decrease in nonaccrual loans is discussed further below.

Impaired loans at December 31, 2011 and 2010, totaled \$12,846,000 and \$14,657,000, respectively. At December 31, 2011 and 2010, \$1,496,000 and \$2,143,000, respectively, of the impaired loans were troubled debt restructured loans, which were also classified as nonaccrual. Loans whose terms are modified are classified as troubled debt restructurings if the borrowers have been granted concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve interest rates being granted below current market rates for the credit risk of the loan or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired. The related allowance for loan losses on impaired loans totaled \$1,181,000 and \$2,059,000, respectively. The decrease in impaired loans was mainly related to loan amounts that were repaid by the borrowers, were charged off or were eliminated by the Corporation taking legal actions to repossess the collateral and then book the fair value of the collateral, less the cost to sell, as foreclosed assets held for resale. Potential problem loans are defined as performing loans that have characteristics that cause management to have doubts as to the ability of the borrower to perform under present loan repayment terms and which may result in the reporting of these loans as non-performing loans in the future. Total additional potential problem loans approximated \$10,807,000 at December 31, 2011, compared to \$15,560,000 at December 31, 2010.

Foreclosed assets held for resale consists of the fair value of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. Fair values are based on appraisals that consider the sale prices of similar properties in the proximate vicinity less estimated selling costs. The fair value of \$4,437,000 at December 31, 2011, included one economic development real estate project and five commercial use real estate properties totaling \$3,135,000. The economic development project has a recorded fair value of \$930,000 and is under a sales agreement with conditions. Five other commercial use real estate properties were brought into foreclosed real estate in 2010 or 2011 with an aggregate fair value of \$2,205,000. In addition, the fair value of \$1,302,000 for foreclosed real estate at December 31, 2011, represented 11 residential real estate single homes, two of which were taken into foreclosed real estate in 2010, the remainder in 2011. All properties are being actively marketed to targeted buyers by external and internal resources. The fair value of \$7,859,000 at December 31, 2010, represented one

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commercial real estate participation loan with a fair value of \$5,180,000 that was sold in 2011 at a gain of \$194,000, and the economic development project, four commercial real estate, and five single homes loans.

*Allowance for Loan Losses*

ACNB maintains the allowance for loan losses at a level believed adequate by management to absorb potential losses in the loan portfolio, and it is funded through a provision for loan losses charged to earnings. On a quarterly basis, ACNB utilizes a defined methodology in determining the adequacy of the allowance for loan losses, which considers specific credit reviews, past loan losses, historical experience, and qualitative factors. This methodology results in an allowance that is considered appropriate in light of the high degree of judgment required and that is prudent and conservative, but not excessive.

Management assigns internal risk ratings for each commercial lending relationship. Utilizing historical loss experience, adjusted for changes in trends, conditions and other relevant factors, management derives estimated losses for non-rated and non-classified loans. When management identifies impaired loans with uncertain collectability of principal and interest, it evaluates a specific reserve on a quarterly basis in order to estimate potential losses. Management's analysis considers:

adverse situations that may affect the borrower's ability to repay;

the current estimated fair value of underlying collateral; and,

prevailing market conditions.

If management determines a loan is not impaired, a specific reserve allocation is not required. Management then places the loan in a pool of loans with similar risk factors and assigns the general loss factor to determine the reserve. For homogeneous loan types, such as consumer and residential mortgage loans, management bases specific allocations on the average loss ratio for the previous three years for each specific loan pool. Additionally, management adjusts projected loss ratios for other factors, including the following:

lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices;

national, regional, and local economic and business conditions, as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans;

nature and volume of the portfolio and terms of loans;

experience, ability and depth of lending management and staff;

volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,

existence and effect of any concentrations of credit and changes in the level of such concentrations.

Management determines the unallocated portion of the allowance for loan losses, which represents the difference between the reported allowance for loan losses and the calculated allowance for loan losses, based on the following criteria:

risk of imprecision in the specific and general reserve allocations;

the perceived level of consumer and small business loans with demonstrated weaknesses for which it is not practicable to develop specific allocations;

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other potential exposure in the loan portfolio;

variances in management's assessment of national and local economic conditions; and,

other internal or external factors that management believes appropriate at that time.

Management believes the above methodology accurately reflects losses inherent in the portfolio. Management charges actual loan losses to the allowance for loan losses. Management periodically updates the methodology and the assumptions discussed above.

Management bases the provision for loan losses, or lack of provision, on the overall analysis taking into account the methodology discussed above.

Federal and state regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

The following tables set forth information on the analysis of the allowance for loan losses and the allocation of the allowance for loan losses as of the dates indicated:

**Table 8 Analysis of Allowance for Loan Losses**

| Dollars in thousands                     | Years Ended December 31, |              |            |              |           |
|--|--------------------------|--------------|------------|--------------|-----------|
|  | 2011                     | 2010         | 2009       | 2008         | 2007      |
| Beginning balance                        | \$ 15,252                | \$ 11,981    | \$ 7,393   | \$ 5,848     | \$ 5,375  |
| Provision for loan losses                | 5,435                    | 6,410        | 4,750      | 5,570        | 500       |
| Loans charged-off:                       |                          |              |            |              |           |
| Commercial, financial and agricultural   | 1,861                    | 204          | 221        | 1,169        | 6         |
| Real estate                              | 2,550                    | 2,049        | 64         | 2,815        |           |
| Consumer                                 | 832                      | 928          | 63         | 68           | 39        |
| <b>Total Loans Charged-Off</b>           | <b>5,243</b>             | <b>3,181</b> | <b>348</b> | <b>4,052</b> | <b>45</b> |
| Recoveries:                              |                          |              |            |              |           |
| Commercial, financial and agricultural   | 34                       | 2            | 172        | 7            | 14        |
| Consumer                                 | 4                        | 40           | 14         | 20           | 4         |
| <b>Total Recoveries</b>                  | <b>38</b>                | <b>42</b>    | <b>186</b> | <b>27</b>    | <b>18</b> |
| Net charge-offs (recoveries)             | 5,205                    | 3,139        | 162        | 4,025        | 27        |
| Ending balance                           | \$ 15,482                | \$ 15,252    | \$ 11,981  | \$ 7,393     | \$ 5,848  |
| Ratios:                                  |                          |              |            |              |           |
| Net charge-offs to average loans         | 0.77%                    | 0.47%        | 0.03%      | 0.68%        | %         |
| Allowance for loan losses to total loans | 2.23%                    | 2.29%        | 1.86%      | 1.16%        | 1.07%     |

Table of Contents**Table 9 Allocation of the Allowance for Loan Losses**

| Dollars in thousands                   | 2011             |                                     | 2010             |                                     | 2009             |                                     | 2008            |                                     | 2007            |                                     |
|--|------------------|-------------------------------------|------------------|-------------------------------------|------------------|-------------------------------------|-----------------|-------------------------------------|-----------------|-------------------------------------|
|  | Amount           | Percent of Loan Type to Total Loans | Amount           | Percent of Loan Type to Total Loans | Amount           | Percent of Loan Type to Total Loans | Amount          | Percent of Loan Type to Total Loans | Amount          | Percent of Loan Type to Total Loans |
| Commercial, financial and agricultural | \$ 2,582         | 8.1%                                | \$ 2,074         | 7.9%                                | \$ 1,539         | 7.1%                                | \$ 1,383        | 9.4%                                | \$ 1,204        | 11.5%                               |
| Real estate:                           |                  |                                     |                  |                                     |                  |                                     |                 |                                     |                 |                                     |
| Commercial                             | 6,007            | 34.0                                | 6,346            | 34.0                                | 4,250            | 28.1                                | 2,034           | 27.3                                | 1,226           | 23.3                                |
| Construction                           | 548              | 3.3                                 | 1,154            | 4.0                                 | 3,086            | 5.9                                 | 1,970           | 7.7                                 | 2,494           | 7.0                                 |
| Residential                            | 3,624            | 52.3                                | 3,108            | 44.6                                | 1,693            | 56.7                                | 1,051           | 53.6                                | 605             | 56.6                                |
| Consumer                               | 926              | 2.3                                 | 861              | 9.5                                 | 403              | 2.2                                 | 325             | 2.0                                 | 207             | 1.6                                 |
| Unallocated                            | 1,795            | N/A                                 | 1,709            | N/A                                 | 1,010            | N/A                                 | 630             | N/A                                 | 112             | N/A                                 |
| <b>Total</b>                           | <b>\$ 15,482</b> | <b>100.0%</b>                       | <b>\$ 15,252</b> | <b>100.0%</b>                       | <b>\$ 11,981</b> | <b>100.0%</b>                       | <b>\$ 7,393</b> | <b>100.0%</b>                       | <b>\$ 5,848</b> | <b>100.0%</b>                       |

The allowance for loan losses at December 31, 2011, was \$15,482,000, or 2.23% of loans, as compared to \$15,252,000, or 2.29% of loans, at December 31, 2010. The ratio of non-performing loans plus foreclosed assets to total assets was 1.84% at December 31, 2011, as compared to 2.43% at December 31, 2010.

Loans past due 90 days and still accruing were \$1,191,000 and nonaccrual loans were \$12,846,000 as of December 31, 2011. Loans past due 90 days and still accruing were \$997,000 at December 31, 2010, while nonaccruals were \$14,657,000.

Additional information on nonaccrual loans at December 31, 2011 and 2010, follows:

| Dollars in thousands                     | Number of Credit Relationships | Balance          | Current Specific Loss Allocations | Current Year Charge-Offs | Location  | Originated |
|--|--------------------------------|------------------|-----------------------------------|--------------------------|-----------|------------|
| <b>December 31, 2011</b>                 |                                |                  |                                   |                          |           |            |
| Residential real estate developments     | 3                              | \$ 2,614         | \$                                | \$ 1,155                 | In market | 2006 2010  |
| Owner occupied commercial real estate    | 13                             | 6,469            | 43                                | 1,196                    | In market | 1995 2010  |
| Investment/rental commercial real estate | 5                              | 1,544            | 53                                | 286                      | In market | 2003 2010  |
| Commercial and industrial                | 3                              | 2,219            | 1,085                             | 1,664                    | In market | 2006 2008  |
| <b>Total</b>                             | <b>24</b>                      | <b>\$ 12,846</b> | <b>\$ 1,181</b>                   | <b>\$ 4,301</b>          |           |            |
| <b>December 31, 2010</b>                 |                                |                  |                                   |                          |           |            |
| Residential real estate developments     | 4                              | \$ 4,388         | \$ 730                            | \$ 1,000                 | In market | 2006       |
| Economic development project*            |                                |                  |                                   | 601                      | In market | 2007       |
| Owner occupied commercial real estate    | 14                             | 8,291            | 719                               |                          | In market | 1995 2008  |
| Investment/rental commercial real estate | 4                              | 1,004            | 61                                | 503                      | In market | 2003 2007  |
| Commercial and industrial                | 1                              | 974              | 549                               | 30                       | In market | 2007       |
| <b>Total</b>                             | <b>23</b>                      | <b>\$ 14,657</b> | <b>\$ 2,059</b>                   | <b>\$ 2,134</b>          |           |            |

\*

Transferred to other real estate owned in the second quarter of 2010.

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All nonaccrual impaired loans are to borrowers located within the market area served by the Corporation in southcentral Pennsylvania and nearby areas of northern Maryland. All nonaccrual impaired loans were originated by ACNB's banking subsidiary, except for one participation loan discussed below, between 1995 and 2010 for purposes listed in the classification in the table above.

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The Corporation has two unrelated impaired loans totaling \$2,520,000 to finance residential real estate development projects in the Corporation's primary trading area of southcentral Pennsylvania, both of which are in nonaccrual of interest status. The loans have standard terms and conditions including repayment from the sales of the respective properties, and no interest reserves. Both loans were originated during the first half of 2006. One loan matured with the inability of the borrower to fund necessary infrastructure improvements, the Corporation charged down the loan by \$2.5 million in 2008 and entered into a forbearance agreement on which the borrower performed until 2010 and then filed bankruptcy. ACNB further wrote down the loan by \$1,000,000 in 2010 and \$804,000 in 2011 reflecting alternative uses for the property and updated observed declines in fair value, respectively. It was expected that various real estate collateral on this loan would be protected by a fair value bid at sheriff sale in 2011, however such sales were delayed by legal actions and are now expected in 2012, after which ACNB will market the property to the appropriate buyers. On the other larger residential real estate loan, foreclosure has been held in abeyance while allowing the pursuit of a workout plan including providing additional collateral and more targeted marketing of the property. This loan was charged-down by \$274,000 in the first quarter of 2011 due to current declines in fair value and subsequently additional paydowns were made by the borrower from sales of collateral in 2011. Because of the 2011 writedowns and principal repayment, there was no specific valuation allowance on these two unrelated loans at December 31, 2011. Two smaller residential real estate development loans totaled \$388,000 when added in 2010; one was settled with a charge down of \$77,000 and subsequently sold without further loss, the other loan was reduced by collateral sales to \$94,000, which is supported by the remaining collateral's current fair value. A third smaller loan in this category was protected by the Bank at sheriff sale in the fourth quarter of 2011, charged down by \$87,000 to fair value less the cost to sale to \$189,000 and carried in foreclosed assets at December 31, 2011.

In the second quarter of 2009, a \$2,200,000 loan to a local economic development corporation was added to nonaccrual status when the loan matured with various sales agreements and grants still pending prior to any further development activity. Subsequent payment reduced the carrying balance to \$1,848,000. Foreclosure processes commenced in the fourth quarter of 2009, and sheriff sale in the first quarter of 2010 resulted in ACNB protecting its interest with a fair value bid. The property was charged down by \$601,000 based on an updated appraisal and transferred into foreclosed assets held for resale in 2010.

Included in impaired commercial and industrial loans is a fully-disbursed line of credit originated in the second quarter of 2007 for a start-up enterprise in the food industry in southcentral Pennsylvania totaling \$234,000 with no specific valuation allowance at December 31, 2011, which is net of a \$1,000,000 charge-off taken in 2008 and an additional charge-off of \$529,000 in 2011. Subsequently, in the third quarter 2011, the borrower entered into an addendum to a prior delinquent forbearance agreement with all required principal forbearance payments made by the borrower. This loan, with standard terms and conditions including repayment from conversion of trade assets continues in default and in nonaccrual status. A second credit to an unrelated borrower was added in the third quarter of 2011 in the amount of \$1,967,000 with a specific allocation of \$1,085,000 and net of a confirmed loss of \$1,135,000, which was charged off in the fourth quarter of 2011. This 2006 participation loan was to a company in the building supplies industry that was negatively impacted by the downturn in housing and the more recent loss of a major distributorship. The specific allocation at December 31, 2011, was derived by analyzing the latest borrower provided accounts receivable data, which is the collateral on the loan.

Owner occupied commercial real estate includes 13 loan relationships, 12 of which have balances less than \$1,000,000 each in which real estate is collateral and is used in connection with a business enterprise that is suffering economic stress or is out of business. These loans were originated between 1995 and 2010. The largest loan in this category had a balance of \$3,508,000 at December 31, 2011, after a partial charge-off of \$598,000 in the first quarter of 2011 due to uncertainty of when further

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legal collection could proceed. Subsequent to December 31, 2011, this loan was settled with a \$250,000 recovery of the 2011 charge-off. Another charge-off of \$509,000 was taken on an unrelated former loan that was transferred to foreclosed assets held for resale in the second quarter of 2011, where it is valued in the amount of \$511,000. The decrease in value was mainly caused by a protracted time period between default and when the Corporation was able to take control of the collateral because of legal actions of the borrower during which the property suffered significant deterioration. The other smaller loans in this category are business loans impacted by the general economic downturn. Collection efforts will continue until it is deemed in the best interest to initiate foreclosure procedures. Two related loans with combined balances of \$711,000 had a charge-off of \$89,000 before being transferred to foreclosed assets held for resale late in the third quarter of 2011. One loan with a balance of \$273,000 had a specific allocation of \$43,000 based on a current appraisal less estimated cost to sell.

Investment/rental commercial real estate includes five loan relationships totaling less than \$1,000,000 each in outstanding balance in which the real estate is collateral and is used for speculation, rental, or other non-owner occupied uses. These loans were originated between 2003 and 2010. These loans were affected by the lack of borrower cash flow to continue to service the debt and in some cases by increased real estate taxes levied by local government units. The plan is to foreclose and subsequently market the real estate if ongoing workout efforts are not successful. One loan in this category has a specific allocation totaling \$53,000 based on the fair value of the related collateral.

The Corporation utilizes a systematic review of its loan portfolio on a quarterly basis in order to determine the adequacy of the allowance for loan losses. In addition, ACNB engages the services of an outside loan review function and sets the timing and coverage of loan reviews during the year. The results of this independent loan review are included in the systematic review of the loan portfolio. The allowance for loan losses consists of a component for individual loan impairment, primarily based on the loan's collateral fair value and expected cash flow. A watch list of loans is identified for evaluation based on internal and external loan grading and reviews. Loans other than those determined to be impaired are grouped into pools of loans with similar credit risk characteristics. These loans are evaluated as groups with allocations made to the allowance based on historical loss experience adjusted for current trends in delinquencies, trends in underwriting and oversight, concentrations of credit, and general economic conditions within the Corporation's trading area. The provision expense was based on the loans discussed above as well as current trends in the watch list and the local economy as a whole. The charge offs discussed elsewhere in this management discussion and analysis create the recent loss history experience and in the qualitative adjustment which, in turn, affects the calculation of losses inherent in the portfolio. The increase in the provision for loan losses for 2010 compared to 2009 was a result of the measurement of the adequacy of the allowance for loan losses at each period-end. Reasons that the 2010 provision was higher include charge-offs, changes in allocations for specific loans, and continued growth in the loan portfolio during 2010 which caused the amounts assigned to homogeneous pools to increase. The provision for loan losses for 2011 compared to 2010 and 2009 was a result of the measurement of the adequacy of the allowance for loan losses at each period. Reasons that the 2011 was lower included the charge-off of loans with specific allocations provided for in the prior year and favorable changes in the mix and credit classifications on other loans. Reasons that the 2010 provision was higher than 2009 included changes in specific allocations requiring provision expense as well as negative changes in the mix and credit classification on other loans.

*Foreclosed Assets Held for Resale*

The carrying value of real estate acquired through foreclosure was \$4,437,000 at December 31, 2011, compared to \$7,859,000 at December 31, 2010. The decrease was mainly due to the full recovery on a commercial use property that had a fair value of \$5,180,000, and was collateral on a commercial loan in which the Corporation took a participation interest from another southcentral Pennsylvania bank. Eight other properties were disposed of in 2011. The largest property unsold at December 31,



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2011 was the economic development property described in *allowance for loan losses* section that is under a sales contract with conditions. The largest additions in 2011 were two local commercial real estate properties with fair values of \$730,000 and \$511,000, respectively, that are being marketed to the appropriate industries. Fourteen additional properties were added and remain unsold between the third quarter of 2010 and December 31, 2011, with an aggregate fair value of \$3,196,000. All properties are actively being marketed. The Corporation expects to obtain and market additional foreclosed assets in 2012; however, the total amount and timing is currently not certain.

*Other Assets*

Other assets decreased \$2,978,000, or 16%, in 2011 compared to 2010, primarily because of the decrease in the net funded status of the banking subsidiary's defined benefit pension plan.

*Deposits*

ACNB relies on deposits as the primary source of funds for lending activities. Average deposits increased 3.0%, or \$22,514,000, during 2011, as compared to 4.1% during 2010. ACNB's deposit pricing function employs a disciplined pricing approach based upon alternative funding rates, but also strives to price deposits to be competitive with relevant local competition, including credit unions and larger regional banks. The 2011 deposit growth mix experienced a continued shift to transaction accounts as customers put more value in liquidity and FDIC insurance. Products, such as money market accounts and interest-bearing transaction accounts that had suffered declines in recent years, continued with recovered balances. With persistent low market interest rates in a slow economy, ACNB's ability to maintain and add to its deposit base may be impacted by the reluctance of consumers to accept low rates and by competition willing to pay above market rates to attract market share. Alternatively, if rates rise rapidly and the equity markets would improve, funds could leave the Corporation or be priced higher to maintain.

**Table 10 Time Deposits**

Maturities of time deposits of \$100,000 or more outstanding at December 31, 2011, are summarized as follows:

**In thousands**

|                                |                  |
|--------------------------------|------------------|
| Three months or less           | <b>\$ 23,513</b> |
| Over three through six months  | <b>5,883</b>     |
| Over six through twelve months | <b>18,187</b>    |
| Over twelve months             | <b>33,399</b>    |
| <b>Total</b>                   | <b>\$ 80,982</b> |

*Borrowings*

Short-term borrowings are comprised primarily of securities sold under agreements to repurchase. As of December 31, 2011, short-term borrowings were \$45,962,000, an increase of \$6,876,000, or 18%, from the December 31, 2010, balance of \$39,086,000. Agreements to repurchase accounts are with the commercial customer base and have attributes similar to core deposits. Investment securities are pledged in sufficient amounts to collateralize these agreements. Compared to year-end 2010, repurchase agreement balances were up \$8,699,000, or 23.3%, due to normal fluctuations in the business activities of ACNB's commercial customer base and low competing rates in similar products. At December 31, 2011, there were no short-term FHLB borrowings, due to sufficient deposit funding. Long-term borrowings consist primarily of longer-term advances from the FHLB; in addition, they include a loan from a commercial bank to fund the purchase of RIG. Long-term borrowings totaled

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\$71,191,000 at December 31, 2011, versus \$81,499,000 at December 31, 2010. The Corporation decreased long-term borrowings by paying off maturing FHLB advances from increased deposits.

| In thousands                                | 2011             | 2010             | 2009             |
|---|------------------|------------------|------------------|
| Amounts outstanding at end of year:         |                  |                  |                  |
| FHLB overnight advance                      | \$               | \$               | \$ 5,150         |
| Securities sold under repurchase agreements | <b>45,962</b>    | 37,263           | 49,504           |
| Treasury tax and loan note                  |                  | 1,823            | 637              |
| <b>Total</b>                                | <b>\$ 45,962</b> | <b>\$ 39,086</b> | <b>\$ 55,291</b> |

| Dollars in thousands                        | 2011             | 2010      | 2009      |
|---|------------------|-----------|-----------|
| Average interest rate at year-end           | <b>0.20%</b>     | 0.23%     | 0.45%     |
| Maximum amount outstanding at any month-end | \$ <b>56,238</b> | \$ 52,577 | \$ 55,379 |
| Average amount outstanding                  | \$ <b>43,124</b> | \$ 42,849 | \$ 46,885 |
| Weighted average interest rate              | <b>0.21%</b>     | 0.28%     | 0.71%     |

### *Capital*

ACNB's capital management strategies have been developed to provide an appropriate rate of return to stockholders, while maintaining its "well capitalized" position. Total stockholders' equity was \$97,474,000 at December 31, 2011, compared to \$93,754,000 at December 31, 2010. Stockholders' equity increased during 2011 partially due to earnings retained in capital during 2011 and offset by a decrease in accumulated other comprehensive income resulting from the increase in value of the assets in the available for sale investment portfolio offset by declines in the pension plan.

The primary source of additional capital to ACNB is earnings retention, which represents net income less dividends declared. During 2011, ACNB retained \$3,990,000, or 47%, of its net income, as compared to \$3,913,000, or 46%, in 2010 and \$2,707,000, or 37%, in 2009.

On January 24, 2011, the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan was introduced for stockholders of record. This plan provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. As of December 31, 2011, 17,466 shares were issued under this plan with proceeds in the amount of \$257,000. Proceeds will be used for general corporate purposes.

ACNB is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on ACNB. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, ACNB must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and reclassifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require ACNB to maintain minimum amounts and ratios of total and Tier 1 capital to average assets. Management believes, as of December 31, 2011 and 2010, that ACNB's banking subsidiary met all minimum capital adequacy requirements to which it is subject and is categorized as "well capitalized". There are no

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conditions or events since the notification that management believes have changed the banking subsidiary's category.

**Table 11 Risk-Based Capital**

The banking subsidiary's capital ratios are as follows:

|   | 2011   | 2010   | To be Well<br>Capitalized under<br>Prompt Corrective<br>Action Regulations |
|---|--------|--------|--|
| Tier 1 leverage ratio (to average assets)                 | 8.24%  | 8.24%  | 5.00%  |
| Tier 1 risk-based capital ratio (to risk-weighted assets) | 12.07% | 11.99% | 6.00%  |
| Total risk-based capital ratio                            | 13.32% | 13.25% | 10.00%   |

For further information on the actual and required capital amounts and ratios, please refer to Note N of the consolidated financial statements.

*Liquidity*

Effective liquidity management ensures the cash flow requirements of depositors and borrowers, as well as the operating cash needs of ACNB, are met.

ACNB's funds are available from a variety of sources, including assets that are readily convertible such as interest bearing deposits with banks, maturities and repayments from the securities portfolio, scheduled repayments of loans receivable, the core deposit base, and the ability to borrow from the FHLB. At December 31, 2011, ACNB could borrow approximately \$297,282,000 from the FHLB of which \$228,282,000 was available. Because of various restrictions and requirements on utilizing the available balance, ACNB considers \$153,000,000 to be the practicable additional borrowing capacity, which is considered to be sufficient for operational needs. The FHLB system is self-capitalizing, member-owned, and its member banks' stock is not publicly traded. ACNB creates its borrowing capacity with the FHLB by granting a security interest in certain loan assets with requisite credit quality. ACNB has reviewed information on the FHLB system and the FHLB of Pittsburgh, and has concluded that they have the capacity and intent to continue to provide both operational and contingency liquidity. The FHLB of Pittsburgh instituted a requirement that a member's investment securities must be moved into a safekeeping account under FHLB control to be considered in the calculation of maximum borrowing capacity. The Corporation currently has securities in safekeeping at the FHLB of Pittsburgh; however, the safekeeping account is under the Corporation's control. As better contingent liquidity is maintained by keeping the securities under the Corporation's control, the Corporation has not moved the securities which, in effect, lowered the Corporation's maximum borrowing capacity. However, there is no practical reduction in borrowing capacity as the securities can be moved into the FHLB-controlled account promptly if they are needed for borrowing purposes.

Another source of liquidity is securities sold under repurchase agreement to customers of ACNB's banking subsidiary totaling \$45,962,000 and \$37,263,000 at December 31, 2011 and 2010, respectively.

The liquidity of the parent company also represents an important aspect of liquidity management. The parent company's cash outflows consist principally of dividends to stockholders and corporate expenses. The main source of funding for the parent company is the dividends it receives from its banking subsidiary. Federal and state banking regulations place certain legal restrictions and other practicable safety and soundness restrictions on dividends paid to the parent company from the subsidiary bank. For a discussion of ACNB's dividend restrictions, please refer to Item 1 "Business" and Note J to the consolidated financial statements.

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ACNB manages liquidity by monitoring projected cash inflows and outflows on a daily basis, and believes it has sufficient funding sources to maintain sufficient liquidity under varying degrees of business conditions.

### *Aggregate Contractual Obligations*

The following table represents the Corporation's on- and off-balance sheet aggregate contractual obligations to make future payments as of December 31, 2011:

| In thousands                 | Less than<br>1 Year | 1 - 3<br>Years    | 4 - 5<br>Years   | Over<br>5 Years  | Total             |
|------------------------------|---------------------|-------------------|------------------|------------------|-------------------|
| Time deposits                | \$ 172,158          | \$ 109,952        | \$ 7,766         | \$               | \$ 289,876        |
| Short term borrowings        | 45,962              |                   |                  |                  | 45,962            |
| Long-term debt               | 21,237              | 25,517            | 17,577           | 6,860            | 71,191            |
| Operating leases             | 385                 | 735               | 548              | 354              | 2,022             |
| Payments under benefit plans | 133                 | 233               | 200              | 3,177            | 3,743             |
| <b>Total</b>                 | <b>\$ 239,875</b>   | <b>\$ 136,437</b> | <b>\$ 26,091</b> | <b>\$ 10,391</b> | <b>\$ 412,794</b> |

In addition, the Corporation in the conduct of business operations routinely enters into contracts for services and equipment. These contracts may require payment to be provided in the future, and may also contain penalty clauses for the early termination of the contracts. Major expenditures are controlled by various approval authorities. Management is not aware of any other commitments or contingent liabilities which may have a material adverse impact on the liquidity or capital resources of the Corporation.

### *Off-Balance Sheet Arrangements*

The Corporation is 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, to a lesser extent, standby letters of credit. At December 31, 2011, the Corporation had unfunded outstanding commitments to extend credit of \$129,586,000 and outstanding standby letters of credit of \$6,230,000. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. Please refer to Note O of the consolidated financial statements for a discussion of the nature, business purpose, and importance of the Corporation's off-balance sheet arrangements.

### *New Accounting Pronouncements*

During 2011, the Financial Accounting Standards Board (FASB) issued new accounting pronouncements that may impact the Corporation's financial condition or results of operations when adopted. See Note A in the Notes to the Consolidated Financial Statements for a summary of these new accounting pronouncements not yet adopted.

## **ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Financial institutions can be exposed to several market risks that may impact the value or future earnings capacity of the organization. These risks involve interest rate risk, foreign currency exchange risk, commodity price risk, and equity market price risk. ACNB's primary market risk is interest rate risk. Interest rate risk is inherent because, as a financial institution, ACNB derives a significant amount of its operating revenue from "purchasing" funds (customer deposits and wholesale borrowings) at various terms and rates. These funds are then invested into earning assets (primarily loans and investments) at various terms and rates. This risk is further discussed below.

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ACNB does not have any exposure to foreign currency exchange risk, commodity price risk, or equity market risk.

*Interest Rate Risk*

Interest rate risk is the exposure to fluctuations in the Corporation's future earnings (earnings at risk) and value (value at risk) resulting from changes in interest rates. This exposure results from differences between the amounts of interest earning assets and interest bearing liabilities that reprice within a specified time period as a result of scheduled maturities and repayment and contractual interest rate changes.

The primary objective of the Corporation's asset/liability management process is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent, appropriate and necessary to ensure the Corporation's profitability. Thus, the goal of interest rate risk management is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at a tolerable level.

Management endeavors to control the exposure to changes in interest rates by understanding, reviewing and making decisions based on its risk position. The banking subsidiary's asset/liability committee is responsible for these decisions. The Corporation primarily uses the securities portfolio and FHLB advances to manage its interest rate risk position. Additionally, pricing, promotion and product development activities are directed in an effort to emphasize the loan and deposit term or repricing characteristics that best meet current interest rate risk objectives. At present, there is no use of hedging instruments.

The asset/liability committee operates under management policies defining guidelines and limits on the level of risk. These policies are approved by the Board of Directors.

The Corporation uses simulation analysis to assess earnings at risk and net present value analysis to assess value at risk. These methods allow management to regularly monitor both the direction and magnitude of the Corporation's interest rate risk exposure. These modeling techniques involve assumptions and estimates that inherently cannot be measured with complete precision. Key assumptions in the analyses include maturity and repricing characteristics of both assets and liabilities, prepayments on amortizing assets, non-maturity deposit sensitivity, and loan and deposit pricing. These assumptions are inherently uncertain due to the timing, magnitude and frequency of rate changes and changes in market conditions and management strategies, among other factors. However, the analyses are useful in quantifying risk and provide a relative gauge of the Corporation's interest rate risk position over time.

*Earnings at Risk*

Simulation analysis evaluates the effect of upward and downward changes in market interest rates on future net interest income. The analysis involves changing the interest rates used in determining net interest income over the next twelve months. The resulting percentage change in net interest income in various rate scenarios is an indication of the Corporation's short-term interest rate risk. The analysis utilizes a "static" balance sheet approach. The measurement date balance sheet composition (or mix) is maintained over the simulation time period, with maturing and repayment dollars being rolled back into like instruments for new terms at current market rates. Additional assumptions are applied to modify volumes and pricing under the various rate scenarios. These include prepayment assumptions on mortgage assets, sensitivity of non-maturity deposit rates, and other factors deemed significant.

The simulation analysis results are presented in Table 13a. These results, as of December 31, 2011, indicate that the Corporation would expect net interest income to decrease over the next twelve months

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by 1.90% assuming an upward ramp in market interest rates of 3.00%, and to decrease by 7.48% if rates ramped downward 3.00%. This profile reflects an acceptable short-term interest rate risk position. A decrease of 3.00% would create an environment in which deposit rates could not practically decline further, thus decreasing net interest income.

Earnings at risk simulations for December 31, 2011, exhibited lower sensitivity in a declining rate environment reflecting an interest rate environment in which larger rate declines could be accommodated.

*Value at Risk*

The net present value analysis provides information on the risk inherent in the balance sheet that might not be taken into account in the simulation analysis due to the shorter time horizon used in that analysis. The net present value of the balance sheet is defined as the discounted present value of expected asset cash flows minus the discounted present value of the expected liability cash flows. The analysis involves changing the interest rates used in determining the expected cash flows and in discounting the cash flows. The resulting percentage change in net present value in various rate scenarios is an indication of the longer term repricing risk and options embedded in the balance sheet.

The net present value analysis results are presented in Table 13b. These results, as of December 31, 2011, indicate that the net present value would increase 3.45% assuming an upward shift in market interest rates of 3.00% and increase 3.67% if rates shifted 1.00% in the same manner.

| December 31, 2011<br>Table 13a<br>Net Interest Income Projections |          | December 31, 2011<br>Table 13b<br>Present Value of Equity |          |
|---|----------|---|----------|
| Changes in<br>Basis Points  | % Change | Changes in<br>Basis Points                                | % Change |
| (300)   | (7.48)%  | (300)   | (14.98)% |
| (100)   | (2.32)%  | (100)   | (8.53)%  |
|   | %        |   | %        |
| 100   | 0.65 %   | 100   | 3.67 %   |
| 300   | 1.90 %   | 300   | 3.45 %   |

| December 31, 2010<br>Table 13a<br>Net Interest Income Projections |          | December 31, 2010<br>Table 13b<br>Present Value of Equity |          |
|---|----------|---|----------|
| Changes in<br>Basis Points  | % Change | Changes in<br>Basis Points                                | % Change |
| (300)   | (4.40)%  | (300)   | (5.10)%  |
| (100)   | (0.56)%  | (100)   | (3.18)%  |
|   | %        |   | %        |
| 100   | (0.35)%  | 100   | 0.98 %   |
| 300   | (0.35)%  | 300   | (2.15)%  |

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**ITEM 8 FINANCIAL STATEMENTS**

- (a) The following audited consolidated financial statements and related documents are set forth in this Annual Report on Form 10-K on the following pages:

|   | <b>Page</b> |
|---|-------------|
| <u>Report of Independent Registered Public Accounting Firm</u>    | <u>55</u>   |
| <u>Consolidated Statements of Condition</u>                       | <u>56</u>   |
| <u>Consolidated Statements of Income</u>                          | <u>57</u>   |
| <u>Consolidated Statements of Changes in Stockholders' Equity</u> | <u>58</u>   |
| <u>Consolidated Statements of Cash Flows</u>                      | <u>59</u>   |
| <u>Notes to Consolidated Financial Statements</u>                 | <u>60</u>   |

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and  
Stockholders of ACNB Corporation  
Gettysburg, Pennsylvania

We have audited the accompanying consolidated statements of condition of ACNB Corporation and Subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2011. ACNB Corporation's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ACNB Corporation and Subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), ACNB Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 12, 2012 expressed an unqualified opinion.

ParenteBeard LLC  
Harrisburg, Pennsylvania  
March 12, 2012



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**ACNB CORPORATION**  
**CONSOLIDATED STATEMENTS OF CONDITION**

|  | December 31,        |                   |
|--|---------------------|-------------------|
| Dollars in thousands,<br>except per share data   | 2011                | 2010              |
| <b>ASSETS</b>  |                     |                   |
| Cash and due from banks  | \$ 14,423           | \$ 14,091         |
| Interest bearing deposits with banks   | 8,200               | 10,082            |
| Cash and Cash Equivalents  | 22,623              | 24,173            |
| Securities available for sale  | 209,227             | 190,730           |
| Securities held to maturity, fair value \$10,680; \$10,671   | 10,032              | 10,044            |
| Loans held for sale  | 337                 | 3,068             |
| Loans, net of allowance for loan losses \$15,482; \$15,252   | 678,986             | 650,039           |
| Premises and equipment   | 14,483              | 14,119            |
| Restricted investment in bank stocks   | 7,146               | 8,420             |
| Investment in bank-owned life insurance  | 28,411              | 27,443            |
| Investments in low-income housing partnerships   | 3,774               | 4,124             |
| Goodwill   | 6,308               | 5,972             |
| Intangible assets  | 3,049               | 3,688             |
| Foreclosed assets held for resale  | 4,437               | 7,859             |
| Other assets   | 16,010              | 18,988            |
| <b>Total Assets</b>  | <b>\$ 1,004,823</b> | <b>\$ 968,667</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                     |                   |
| <b>LIABILITIES</b>   |                     |                   |
| Deposits:  |                     |                   |
| Non-interest bearing   | \$ 112,247          | \$ 103,464        |
| Interest bearing   | 670,548             | 643,062           |
| <b>Total Deposits</b>  | <b>782,795</b>      | <b>746,526</b>    |
| Short-term borrowings  | 45,962              | 39,086            |
| Long-term borrowings   | 71,191              | 81,499            |
| Other liabilities  | 7,401               | 7,802             |
| <b>Total Liabilities</b>   | <b>907,349</b>      | <b>874,913</b>    |
| <b>STOCKHOLDERS' EQUITY</b>  |                     |                   |
| Common stock, \$2.50 par value; 20,000,000 shares authorized; 6,008,409 and 5,990,943 shares issued;<br>5,945,809 and 5,928,343 shares outstanding | 15,021              | 14,977            |
| Treasury stock, at cost (62,600 shares)  | (728)               | (728)             |
| Additional paid-in capital   | 9,000               | 8,787             |
| Retained earnings  | 73,526              | 69,536            |
| Accumulated other comprehensive income   | 655                 | 1,182             |
| <b>Total Stockholders' Equity</b>  | <b>97,474</b>       | <b>93,754</b>     |
| <b>Total Liabilities and Stockholders' Equity</b>  | <b>\$ 1,004,823</b> | <b>\$ 968,667</b> |

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



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## ACNB CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

|  | Years Ended December 31, |               |               |
|--|--------------------------|---------------|---------------|
| Dollars in thousands,<br>except per share data             | 2011                     | 2010          | 2009          |
| <b>INTEREST INCOME</b>                                     |                          |               |               |
| Loans, including fees                                      | \$ 34,493                | \$ 36,043     | \$ 35,626     |
| Securities:  |                          |               |               |
| Taxable  | 6,006                    | 7,181         | 8,620         |
| Tax-exempt   | 1,252                    | 1,308         | 1,488         |
| Dividends  | 13                       | 26            | 38            |
| Other  | 68                       | 82            | 40            |
| <b>Total Interest Income</b>                               | <b>41,832</b>            | <b>44,640</b> | <b>45,812</b> |
| <b>INTEREST EXPENSE</b>                                    |                          |               |               |
| Deposits   | 4,457                    | 6,223         | 9,307         |
| Short-term borrowings                                      | 91                       | 119           | 331           |
| Long-term borrowings                                       | 2,914                    | 3,281         | 3,922         |
| <b>Total Interest Expense</b>                              | <b>7,462</b>             | <b>9,623</b>  | <b>13,560</b> |
| <b>Net Interest Income</b>                                 | <b>34,370</b>            | <b>35,017</b> | <b>32,252</b> |
| <b>PROVISION FOR LOAN LOSSES</b>                           | <b>5,435</b>             | <b>6,410</b>  | <b>4,750</b>  |
| <b>Net Interest Income after Provision for Loan Losses</b> | <b>28,935</b>            | <b>28,607</b> | <b>27,502</b> |
| <b>OTHER INCOME</b>  |                          |               |               |
| Service charges on deposit accounts                        | 2,418                    | 2,415         | 2,402         |
| Income from fiduciary activities                           | 1,396                    | 1,303         | 1,057         |
| Earnings on investment in bank-owned life insurance        | 968                      | 1,002         | 1,011         |
| Gain on life insurance proceeds                            |                          | 78            |               |
| Gains on sales/calls of securities                         | 1                        | 72            | 17            |
| Impairment charges on equity securities                    |                          |               | (522)         |
| Service charges on ATM and debit card transactions         | 1,236                    | 1,124         | 1,002         |
| Commissions from insurance sales                           | 4,824                    | 4,949         | 5,484         |
| Other  | 894                      | 1,229         | 1,252         |
| <b>Total Other Income</b>                                  | <b>11,737</b>            | <b>12,172</b> | <b>11,703</b> |
| <b>OTHER EXPENSES</b>                                      |                          |               |               |
| Salaries and employee benefits                             | 17,138                   | 17,318        | 17,680        |
| Net occupancy  | 2,043                    | 2,197         | 2,281         |
| Equipment  | 2,620                    | 2,499         | 2,175         |
| Professional services                                      | 911                      | 1,116         | 860           |
| Other tax  | 803                      | 791           | 665           |
| Supplies and postage                                       | 640                      | 717           | 688           |
| Marketing  | 478                      | 458           | 430           |
| FDIC and regulatory  | 1,026                    | 1,434         | 1,958         |
| Intangible assets amortization                             | 641                      | 641           | 638           |
| Foreclosed real estate expenses                            | 725                      | 292           | 18            |
| Other operating  | 2,991                    | 2,840         | 3,236         |
| <b>Total Other Expenses</b>                                | <b>30,016</b>            | <b>30,303</b> | <b>30,629</b> |

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|                                   |                 |          |          |
|-----------------------------------|-----------------|----------|----------|
| <b>Income before Income Taxes</b> | <b>10,656</b>   | 10,476   | 8,576    |
| <b>PROVISION FOR INCOME TAXES</b> | <b>2,154</b>    | 2,057    | 1,357    |
| <b>Net Income</b>                 | <b>\$ 8,502</b> | \$ 8,419 | \$ 7,219 |
| <b>PER SHARE DATA</b>             |                 |          |          |
| Basic earnings                    | <b>\$ 1.43</b>  | \$ 1.42  | \$ 1.22  |
| Cash dividends declared           | <b>\$ 0.76</b>  | \$ 0.76  | \$ 0.76  |

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

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## ACNB CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 2011, 2010 and 2009

| Dollars in thousands                       | Common<br>Stock | Treasury<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders'<br>Equity |
|--|-----------------|-------------------|----------------------------------|----------------------|---|----------------------------------|
| <b>BALANCE JANUARY 1, 2009</b>             | \$ 14,977       | \$ (442)          | \$ 8,787                         | \$ 62,916            | \$ (1,799)  | \$ 84,439                        |
| Comprehensive income:                      |                 |                   |                                  |                      |   |                                  |
| Net income                                 |                 |                   |                                  | 7,219                |   | 7,219                            |
| Other comprehensive income, net of taxes   |                 |                   |                                  |                      | 1,443   | 1,443                            |
| <b>Total Comprehensive Income</b>          |                 |                   |                                  |                      |   | 8,662                            |
| Treasury stock purchased (27,600 shares)   |                 | (286)             |                                  |                      |   | (286)                            |
| Cash dividends declared                    |                 |                   |                                  | (4,512)              |   | (4,512)                          |
| <b>BALANCE DECEMBER 31, 2009</b>           | 14,977          | (728)             | 8,787                            | 65,623               | (356)   | 88,303                           |
| Comprehensive income:                      |                 |                   |                                  |                      |   |                                  |
| Net income                                 |                 |                   |                                  | 8,419                |   | 8,419                            |
| Other comprehensive income, net of taxes   |                 |                   |                                  |                      | 1,538   | 1,538                            |
| <b>Total Comprehensive Income</b>          |                 |                   |                                  |                      |   | 9,957                            |
| Cash dividends declared                    |                 |                   |                                  | (4,506)              |   | (4,506)                          |
| <b>BALANCE DECEMBER 31, 2010</b>           | 14,977          | (728)             | 8,787                            | 69,536               | 1,182   | 93,754                           |
| Comprehensive income:                      |                 |                   |                                  |                      |   |                                  |
| Net income                                 |                 |                   |                                  | 8,502                |   | 8,502                            |
| Other comprehensive loss, net of taxes     |                 |                   |                                  |                      | (527)   | (527)                            |
| <b>Total Comprehensive Income</b>          |                 |                   |                                  |                      |   | 7,975                            |
| Common stock shares issued (17,466 shares) | 44              |                   | 213                              |                      |   | 257                              |
| Cash dividends declared                    |                 |                   |                                  | (4,512)              |   | (4,512)                          |
| <b>BALANCE DECEMBER 31, 2011</b>           | \$ 15,021       | \$ (728)          | \$ 9,000                         | \$ 73,526            | \$ 655  | \$ 97,474                        |

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

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## ACNB CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| In thousands   | Years Ended December 31, |                |                 |
|--|--------------------------|----------------|-----------------|
|  | 2011                     | 2010           | 2009            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                          |                |                 |
| Net income   | \$ 8,502                 | \$ 8,419       | \$ 7,219        |
| Adjustments to reconcile net income to net cash provided by operating activities:                          |                          |                |                 |
| Net (gain) loss on sales of loans and foreclosed real estate, net of write-downs on foreclosed real estate | 38                       | (275)          | (502)           |
| Earnings on investment in bank-owned life insurance  | (968)                    | (1,002)        | (1,011)         |
| Impairment charges on equity securities  |                          |                | 522             |
| Gain on sales/calls of securities  | (1)                      | (72)           | (17)            |
| Gain on life insurance proceeds  |                          | (78)           |                 |
| Depreciation and amortization  | 2,218                    | 2,342          | 2,281           |
| Provision for loan losses  | 5,435                    | 6,410          | 4,750           |
| Net amortization (accretion) of investment securities premiums (discounts)                                 | 682                      | 150            | (173)           |
| Decrease (increase) in interest receivable   | (257)                    | 241            | 565             |
| Decrease in interest payable   | (238)                    | (455)          | (924)           |
| Mortgage loans originated for sale   | (15,414)                 | (38,877)       | (51,562)        |
| Proceeds from loans sold to others   | 18,403                   | 36,394         | 52,952          |
| (Increase) decrease in other assets  | 3,857                    | (5,872)        | (3,845)         |
| Increase (decrease) in other liabilities   | (4,103)                  | 1,583          | 158             |
| <b>Net Cash Provided by Operating Activities</b>   | <b>18,154</b>            | <b>8,908</b>   | <b>10,413</b>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                          |                |                 |
| Proceeds from maturities of investment securities available for sale                                       | 55,804                   | 67,442         | 71,407          |
| Proceeds from sales of investment securities available for sale  |                          | 6,561          | 2,956           |
| Purchase of investment securities available for sale   | (71,830)                 | (55,356)       | (31,403)        |
| Purchase of investments held to maturity   |                          |                | (10,064)        |
| Redemption of restricted investment in bank stocks   | 1,274                    | 750            |                 |
| Net increase in loans  | (37,672)                 | (26,620)       | (12,762)        |
| Purchase of bank-owned life insurance  |                          | (250)          | (100)           |
| Insurance agency acquisitions, net of cash acquired  | (336)                    | (31)           | (43)            |
| Proceeds from life insurance death benefits  |                          | 295            |                 |
| Capital expenditures   | (1,942)                  | (1,089)        | (1,951)         |
| Proceeds from sale of property and foreclosed real estate  | 6,416                    | 928            | 151             |
| <b>Net Cash Provided by (Used in) Investing Activities</b>   | <b>(48,286)</b>          | <b>(7,370)</b> | <b>18,191</b>   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                          |                |                 |
| Net increase in demand deposits  | 8,783                    | 9,635          | 11,343          |
| Net increase in time certificates of deposits and interest bearing deposits                                | 27,486                   | 8,368          | 26,883          |
| Net increase (decrease) in short-term borrowings   | 6,876                    | (16,205)       | (28,162)        |
| Proceeds from long-term borrowings   |                          | 22,000         | 14,000          |
| Repayments on long-term borrowings   | (10,308)                 | (20,795)       | (40,657)        |
| Dividends paid   | (4,512)                  | (4,506)        | (4,512)         |
| Common stock issued  | 257                      |                |                 |
| Purchase of treasury stock   |                          |                | (286)           |
| <b>Net Cash Provided by (Used in) Financing Activities</b>   | <b>28,582</b>            | <b>(1,503)</b> | <b>(21,391)</b> |

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|   |                  |                  |                  |
|---|------------------|------------------|------------------|
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b> | <b>(1,550)</b>   | <b>35</b>        | <b>7,213</b>     |
| <b>CASH AND CASH EQUIVALENTS BEGINNING</b>                  | <b>24,173</b>    | <b>24,138</b>    | <b>16,925</b>    |
| <b>CASH AND CASH EQUIVALENTS ENDING</b>                     | <b>\$ 22,623</b> | <b>\$ 24,173</b> | <b>\$ 24,138</b> |
| Interest paid   | \$ 7,700         | \$ 10,078        | \$ 14,484        |
| Income taxes paid   | \$ 1,700         | \$ 2,300         | \$ 2,700         |
| Loans transferred to foreclosed real estate                 | \$ 3,290         | \$ 2,877         | \$ 5,636         |

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

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**ACNB CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations**

ACNB Corporation (the Corporation or ACNB), headquartered in Gettysburg, Pennsylvania, provides banking, insurance, and financial services to businesses and consumers through its wholly-owned subsidiaries, ACNB Bank (Bank) and Russell Insurance Group, Inc. (RIG). The Bank engages in full-service commercial and consumer banking and trust services through its nineteen retail banking locations in Adams, Cumberland and York Counties, Pennsylvania. There are also two loan production offices situated in York and Franklin Counties, Pennsylvania.

RIG is a full-service insurance agency, based in Westminster, Maryland. The agency offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients. In 2008, due to an agency acquisition, a second location of RIG was established in Germantown, Maryland.

The Corporation, along with seven other banks, entered into a joint venture to form BankersRe Insurance Group, SPC (formerly Pennbanks Insurance Co., SPC), an offshore reinsurance company. Each participating entity owns an insurance cell through which its premiums and losses from credit life, health and accident insurance are funded. Each entity is responsible for the activity in its respective cell. The financial activity for the Corporation's insurance cell is included in the consolidated financial statements and is not material to the consolidated financial statements.

The Corporation's primary source of revenue is interest income on loans and investment securities and fee income on its products and services. Expenses consist of interest expense on deposits and borrowed funds, provisions for loan losses, and other operating expenses.

**Basis of Financial Statements**

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and include the accounts of the Corporation and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated.

Assets held by the Corporation's Trust Department in an agency or fiduciary capacity for its customers are excluded from the consolidated financial statements since they do not constitute assets of the Corporation. Assets held by the Trust Department amounted to \$135,000,000 and \$152,000,000 at December 31, 2011 and 2010, respectively. Income from fiduciary activities is recognized on the cash method, which approximates the accrual method.

Certain amounts previously reported have been reclassified, when necessary, to conform to the financial statement presentation for 2011. The reclassification had no effect on net income or stockholders' equity.

The Corporation has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2011, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued. One owner occupied commercial real estate loan had a balance of \$3,508,000 at December 31, 2011, after a partial charge-off of \$598,000 in the first quarter of 2011 due to uncertainty of when further legal collection could proceed. Subsequent to December 31, 2011 this loan was settled with a \$250,000 recovery of the 2011 charge-off.



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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Use of Estimates**

Financial statements prepared in accordance with GAAP require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ from these estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of deferred tax assets, the determination of other than temporary impairment on securities, and the potential impairment of goodwill.

**Significant Group Concentrations of Credit Risk**

Most of the Corporation's activities are with customers located within southcentral Pennsylvania and northern Maryland. Note C discusses the types of securities in which the Corporation invests. Note D discusses the types of lending in which the Corporation engages. Included in commercial real estate loans are loans made to lessors of non-residential dwellings that total \$99,700,000, or 14%, of total loans at December 31, 2011. These borrowers are geographically disbursed throughout ACNB's market place and are leasing commercial properties to a varied group of tenants including medical offices, retail space and recreational facilities. Because of the varied nature of the tenants in aggregate, management believes that these loans do not present any greater risk than commercial loans in general.

**Cash and Cash Equivalents**

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, balances due from banks, and federal funds sold, all of which mature within ninety days.

**Securities**

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported, net of tax, in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the securities, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management's intention and ability to hold the securities until recovery of unrealized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

**Restricted Investment in Bank Stocks**

Restricted investment in bank stocks, which represents required investments in the common stock of correspondent banks, is carried at cost as of December 31, 2011 and 2010, and consists of common stock in the Atlantic Central Bankers Bank and Federal Home Loan Bank (FHLB). In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

repurchase of capital stock. However, beginning in 2010, the FHLB of Pittsburgh resumed repurchasing excess capital stock held by member banks of the FHLB.

Management evaluates the restricted investment in bank stocks for impairment in accordance with Accounting Standard Codification (ASC) Topic 942, *Financial Services Depository and Lending*. Management's determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the correspondent bank as compared to the capital stock amount for the correspondent bank and the length of time this situation has persisted, (2) commitments by the correspondent bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of the correspondent bank, (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the correspondent bank, and (4) the liquidity position of the correspondent bank.

Management believes no impairment charge was necessary related to the restricted investment in bank stocks during 2011, 2010 or 2009. However, security impairment analysis is completed quarterly, and the determination that no impairment has occurred during those years is no assurance that impairment may not occur in future periods.

**Loans Held for Sale**

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by aggregate outstanding commitments from investors or current investor yield requirements. Net unrealized losses are recognized through a valuation allowance by charges to income.

Mortgage loans held for sale are sold with the mortgage servicing rights released to another financial institution through a correspondent relationship. The correspondent financial institution absorbs all of the risk related to rate lock commitments. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

**Loans**

The Corporation grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout southcentral Pennsylvania and northern Maryland. The ability of the Corporation's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The loans receivable portfolio is segmented into commercial, residential mortgage, home equity lines of credit, and consumer loans. Commercial loans consist of the following classes: commercial and industrial, commercial real estate, and commercial real estate construction.

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The accrual of interest on residential mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans (consisting of home equity lines of credit and consumer loan classes) are typically charged off no later than 120 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued, but not collected, for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**Allowance for Credit Losses**

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses (the "allowance") is established as losses are estimated to occur through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated statement of condition. The amount of the unfunded lending commitment is not material to the consolidated statements.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific components relate to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity, and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices;

national, regional and local economic and business conditions, as well as the condition of various market segments, including the impact on the value of underlying collateral for collateral dependent loans.

the nature and volume of the portfolio and terms of loans;

the experience, ability and depth of lending management and staff;

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

the volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,

the existence and effect of any concentrations of credit and changes in the level of such concentrations.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and commercial construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

A specific allocation within the allowance for loan losses is established for an impaired loan if its carrying value exceeds its estimated fair value. The estimated fair values of substantially all of the Corporation's impaired loans are measured based on the estimated fair value of the loan's collateral.

For commercial loans secured by real estate, estimated fair values of collateral are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal, and the condition of the property. Appraised values are discounted based on the age of the appraisal, special use nature of the property, or condition of the property to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging reports, equipment appraisals, or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Loans whose terms are modified are classified as troubled debt restructured loans if the Corporation grants such borrowers concessions that it would not otherwise consider and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate, continuance of a below market interest rate, or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings may be restored to accrual status if principal and interest payments, under the modified terms, are current for a sustained period of time and, based on a well-documented credit evaluation of the borrower's financial condition, there is reasonable assurance of repayment. Loans classified as troubled debt restructurings are generally designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into credit quality rating categories. The borrower's overall financial condition, repayment sources, guarantors, and value of collateral, if appropriate, are generally evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments.

Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans classified special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

In addition, federal and state regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

**Commercial and Industrial Lending** The Corporation originates commercial and industrial loans primarily to businesses located in its primary market area and surrounding areas. These loans are used for various business purposes which include short-term loans and lines of credit to finance machinery and equipment purchases, inventory and accounts receivable. Generally, the maximum term for loans extended on machinery and equipment is based on the projected useful life of such machinery and equipment. Most business lines of credit are written on demand and may be renewed annually.

Commercial and industrial loans are generally secured with short-term assets; however, in many cases, additional collateral such as real estate is provided as additional security for the loan. Loan-to-value maximum values have been established by the Corporation and are specific to the type of collateral. Collateral values may be determined using invoices, inventory reports, accounts receivable aging reports, collateral appraisals, etc.

In underwriting commercial and industrial loans, an analysis is performed to evaluate the borrower's character and capacity to repay the loan, the adequacy of the borrower's capital and collateral, as well as the conditions affecting the borrower. Evaluation of the borrower's past, present and future cash flows is also an important aspect of the Corporation's analysis.

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Commercial loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions.

**Commercial Real Estate Lending** The Corporation engages in commercial real estate lending in its primary market area and surrounding areas. The Corporation's commercial loan portfolio is secured primarily by commercial retail space, office buildings, and hotels. Generally, commercial real estate loans have terms that do not exceed 20 years, have loan-to-value ratios of up to 80% of the appraised value of the property, and are typically secured by personal guarantees of the borrowers.

In underwriting these loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower's credit history, and the reliability and predictability of the cash flow generated by the property securing the loan. Appraisals on properties securing commercial real estate loans originated by the Corporation are performed by independent appraisers.

Commercial real estate loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the complexities involved in valuing the underlying collateral.

**Commercial Real Estate Construction Lending** The Corporation engages in commercial real estate construction lending in its primary market area and surrounding areas. The Corporation's commercial real estate construction lending consists of commercial and residential site development loans, as well as commercial building construction and residential housing construction loans.

The Corporation's commercial real estate construction loans are generally secured with the subject property. Terms of construction loans depend on the specifics of the project, such as estimated absorption rates, estimated time to complete, etc.

In underwriting commercial real estate construction loans, the Corporation performs a thorough analysis of the financial condition of the borrower, the borrower's credit history, the reliability and predictability of the cash flow generated by the project using feasibility studies, market data, etc. Appraisals on properties securing commercial real estate construction loans originated by the Corporation are performed by independent appraisers.

Commercial real estate construction loans generally present a higher level of risk than other types of loans due primarily to the effect of general economic conditions and the uncertainties surrounding total construction costs.

**Residential Mortgage Lending** One-to-four family residential mortgage loan originations are generated by the Corporation's marketing efforts, its present customers, walk-in customers, and referrals. These loans originate primarily within the Corporation's market area or with customers primarily from the market area.

The Corporation offers fixed-rate and adjustable-rate mortgage loans with terms up to a maximum of 30 years for both permanent structures and those under construction. The Corporation's one-to-four family residential mortgage originations are secured primarily by properties located in its primary market area and surrounding areas. The majority of the Corporation's residential mortgage loans originate with a loan-to-value of 80% or less. Loans in excess of 80% are required to have private mortgage insurance.

In underwriting one-to-four family residential real estate loans, the Corporation evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Properties securing real estate loans made by the Corporation are appraised by independent appraisers. The Corporation generally requires borrowers to obtain an attorney's title opinion or title insurance, as

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

well as fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. The Corporation has not engaged in subprime residential mortgage originations.

Residential mortgage loans present a moderate level of risk due primarily to general economic conditions, as well as a currently weakened housing market.

**Home Equity Lines of Credit Lending** The Corporation originates home equity lines of credit primarily within the Corporation's market area or with customers primarily from the market area. Home equity lines of credit are generated by the Corporation's marketing efforts, its present customers, walk-in customers, and referrals.

Home equity lines of credit are secured by the borrower's primary residence with a maximum loan-to-value of 90% and a maximum term of 20 years. In underwriting home equity lines of credit, a thorough analysis of the borrower's financial ability to repay the loan as agreed is performed. The ability to repay is determined by the borrower's employment history, current financial condition, and credit background.

Home equity lines of credit generally present a moderate level of risk due primarily to general economic conditions, as well as a currently weakened housing market.

**Consumer Lending** The Corporation offers a variety of secured and unsecured consumer loans, including those for vehicles and mobile homes and loans secured by savings deposits. These loans originate primarily within the Corporation's market area or with customers primarily from the market area.

Consumer loan terms vary according to the type and value of collateral and the creditworthiness of the borrower. In underwriting consumer loans, a thorough analysis of the borrower's financial ability to repay the loan as agreed is performed. The ability to repay shall be determined by the borrower's employment history, current financial condition, and credit background.

Consumer loans may entail greater credit risk than residential mortgage loans or home equity lines of credit, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets such as automobiles or recreational equipment. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

**Off-Balance Sheet Credit Related Financial Instruments**

In the ordinary course of business, the Corporation has entered into commitments to extend credit, including commitments under commercial lines of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

**Foreclosed Assets**

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are adjusted to the

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

fair value, less costs to sell as necessary. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

**Premises and Equipment**

Land is carried at cost. Buildings, furniture, fixtures, equipment and leasehold improvements are carried at cost, less accumulated depreciation. Depreciation is computed principally by the straight-line method over the assets' estimated useful lives. Maintenance and normal repairs are charged to expense when incurred while major additions and improvements are capitalized. Gains and losses on disposals are reflected in current operations. Amortization of leasehold improvements is computed by straight line over the shorter of the assets' useful life or the related lease term.

**Investments in Low-Income Housing Partnerships**

The Corporation's investments in low-income housing partnerships are accounted for using the "equity method" prescribed by ASC Topic 323. In accordance with ASC Topic 740, tax credits are recognized as they become available. Any residual loss is amortized as the tax credits are received.

**Bank-Owned Life Insurance**

The Corporation's banking subsidiary maintains nonqualified compensation plans for selected senior officers. To fund the benefits under these plans, the Bank is the owner of single premium life insurance policies on participants in the nonqualified retirement plans. Investment in bank-owned life insurance policies was used to finance the nonqualified compensation plans and provide tax-exempt income to the Corporation.

ASC Topic 715, *Compensation Retirement Benefits*, requires a liability to be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability is based on either the post-employment benefit cost for continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. The Corporation's liability is based on the post-employment benefit cost for continuing life insurance. The Corporation incurred approximately \$22,000, \$48,000, and \$45,000 of expense in 2011, 2010, and 2009, respectively, related to this accounting pronouncement.

**Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

**Income Taxes**

The Corporation accounts for Income Taxes in accordance with income tax accounting guidance ASC Topic 740, *Income Taxes*.

Current income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over



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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

revenues. The Corporation determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of the evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Corporation accounts for uncertain tax positions if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-than-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

The Corporation recognizes interest and penalties on income taxes, if any, as a component of income tax expense.

**Retirement Plan**

The compensation cost of an employee's pension benefit is recognized on the projected unit credit method over the employee's approximate service period. The aggregate cost method is utilized for funding purposes.

**Net Income per Share**

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 5,936,030, 5,928,343 and 5,936,001 weighted average shares of common stock outstanding for 2011, 2010 and 2009, respectively.

**Advertising Costs**

Costs of advertising, which are included in marketing expenses, are expensed when incurred.

**Intangible Assets**

The Corporation accounts for its acquisitions using the purchase accounting method required by ASC Topic 805, *Business Combinations*. Purchase accounting requires the total purchase price to be allocated to the estimated fair values of assets and liabilities acquired, including certain intangible assets that must be recognized. Generally, this results in a residual amount in excess of the net fair values, which is recorded as goodwill.

Table of Contents**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

ASC Topic 350, *Intangibles - Goodwill and Other*, requires that goodwill is not amortized to expense, but rather that it be tested for impairment at least annually. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. The Corporation did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of December 31, 2011. Other acquired intangible assets with finite lives, such as customer lists, are required to be amortized over the estimated lives. These intangibles are generally amortized using the straight line method over estimated useful lives of ten years.

**Comprehensive Income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Changes in certain assets and liabilities, such as unrealized gains (losses) on securities available for sale and the pension liability, are reported as a separate component of the stockholders' equity section of the statement of condition. Such items, along with net income, are components of comprehensive income.

The components of other comprehensive income (loss) and the related tax effects are as follows:

| In thousands  | Years Ended December 31, |                 |                 |
|---|--------------------------|-----------------|-----------------|
|   | 2011                     | 2010            | 2009            |
| Unrealized holding gains (losses) arising during the period           | \$ 3,141                 | \$ (358)        | \$ 116          |
| Reclassification adjustment for (gains) losses realized in net income | (1)                      | (72)            | 505             |
| Net unrealized gains (losses)   | 3,140                    | (430)           | 621             |
| Tax effect  | 1,067                    | 147             | (211)           |
|   | 2,073                    | (283)           | 410             |
| Change in pension liability   | (3,938)                  | 2,760           | 1,565           |
| Tax effect  | 1,338                    | (939)           | (532)           |
|   | (2,600)                  | 1,821           | 1,033           |
| <b>Other Comprehensive Income (Loss)</b>                              | <b>\$ (527)</b>          | <b>\$ 1,538</b> | <b>\$ 1,443</b> |

The components of the accumulated other comprehensive income, net of taxes, are as follows:

| In thousands |                   | Unrealized<br>Gains on<br>Securities | Pension<br>Liability | Accumulated                      |
|--------------|-------------------|--------------------------------------|----------------------|----------------------------------|
|              |                   |                                      |                      | Other<br>Comprehensive<br>Income |
| BALANCE      | DECEMBER 31, 2010 | \$ 3,923                             | \$ (2,741)           | \$ 1,182                         |
| BALANCE      | DECEMBER 31, 2011 | \$ 5,996                             | \$ (5,341)           | \$ 655                           |

**Segment Reporting**

The Bank acts as an independent community financial services provider, which offers traditional banking and related financial services to individual business and government customers. Through its branch and automated teller machine networks, 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. Management does not separately allocate expenses, including the cost of funding loan demand, between the

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

commercial, retail and mortgage banking operations of the Bank. As such, discrete financial information for commercial, retail and mortgage banking operations is not available and segment reporting would not be meaningful. See Note S for a discussion of insurance operations.

**New Accounting Pronouncements**

**ASU 2011-03**

The Financial Accounting Standards Board (FASB) has issued this Accounting Standard Update (ASU) to clarify the accounting principles applied to repurchase agreements, as set forth by FASB ASC Topic 860, *Transfers and Servicing*. This ASU, entitled "*Reconsideration of Effective Control for Repurchase Agreements*", amends one of three criteria used to determine whether or not a transfer of assets may be treated as a sale by the transferor. Under Topic 860, the transferor may not maintain effective control over the transferred assets in order to qualify as a sale. This ASU eliminates the criteria under which the transferor must retain collateral sufficient to repurchase or redeem the collateral on substantially agreed upon terms as a method of maintaining effective control. This ASU is effective for both public and nonpublic entities for interim and annual reporting periods beginning on or after December 15, 2011, and requires prospective application to transactions or modifications of transactions which occur on or after the effective date. Early adoption is not permitted.

The Corporation does not expect the adoption of this standard will have a significant impact on its consolidated financial condition or results of operations.

**ASU 2011-04**

This ASU amends FASB ASC Topic 820, *Fair Value Measurements*, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The ASU clarifies existing guidance for items such as: the application of the highest and best use concept to nonfinancial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity's stockholders' equity; and, disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of Level 3 assets. The ASU also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The ASU also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in Level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as Level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and, categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. For public entities, this ASU is effective for interim and annual periods beginning after December 15, 2011. For nonpublic entities, the ASU is effective for annual periods beginning after December 15, 2011. Early adoption is not permitted.

The Corporation does not expect the adoption of this standard will have a significant impact on its consolidated financial condition or results of operations.

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**ASU 2011-05/ASU 2011-12**

The provisions of this ASU amend FASB ASC Topic 220, *Comprehensive Income*, to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The ASU prohibits the presentation of the components of comprehensive income in the statement of stockholders' equity. Reporting entities are allowed to present either a statement of comprehensive income, which reports both net income and other comprehensive income, or separate, but consecutive, statements of net income and other comprehensive income. Under previous GAAP, all three presentations were acceptable. Regardless of the presentation selected, the reporting entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. The provisions of this ASU are effective for fiscal years and interim periods beginning after December 15, 2011, for public entities. For nonpublic entities, the provisions are effective for fiscal years ending after December 15, 2012, and for interim and annual periods thereafter. As the two remaining options for presentation existed prior to the issuance of this ASU, early adoption is permitted.

In December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05*. In response to stakeholder concerns regarding the operational ramifications of the presentation of these reclassifications for current and previous years, the FASB has deferred the implementation date of this provision to allow time for further consideration. The requirement in ASU 2011-05, *Presentation of Comprehensive Income*, for the presentation of a combined statement of comprehensive income or separate, but consecutive, statements of net income and other comprehensive income is still effective for fiscal years and interim periods beginning after December 15, 2011, for public companies, and fiscal years ending after December 15, 2011, for nonpublic companies.

The Corporation does not expect the adoption of these standards to have a significant impact on its consolidated financial condition or results of operations.

**ASU 2011-08**

In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment*. The purpose of this ASU is to simplify how entities test goodwill for impairment by adding a new first step to the preexisting goodwill impairment test under ASC Topic 350, *Intangibles - Goodwill and Other*. This amendment gives the entity the option to first assess a variety of qualitative factors such as economic conditions, cash flows, and competition to determine whether it was more likely than not that the fair value of goodwill has fallen below its carrying value. If the entity determines that it is not likely that the fair value has fallen below its carrying value, then the entity will not have to complete the original two-step test under Topic 350. The amendments in this ASU are effective for impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted.

The Corporation is evaluating the impact of this standard on its consolidated financial statements.

**ASU 2011-10**

In December 2011, the FASB issued ASU 2011-10, *Derecognition of in Substance Real Estate - a Scope Clarification*. This ASU clarifies previous guidance for situations in which a reporting entity would relinquish control of the assets of a subsidiary in order to satisfy the nonrecourse debt of the subsidiary. The ASU concludes that if control of the assets has been transferred to the lender, but not legal ownership of the assets; then the reporting entity must continue to include the assets of the subsidiary in its consolidated financial statements. The amendments in this ASU are effective for public

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**NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

entities for annual and interim periods beginning on or after June 15, 2012. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2013. Early adoption is permitted.

The Corporation is evaluating the impact of this standard on its consolidated financial statements.

**ASU 2011-11**

In December 2011, the FASB issued ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities*, in an effort to improve comparability between U.S. GAAP and IFRS financial statements with regard to the presentation of offsetting assets and liabilities on the statement of financial position arising from financial and derivative instruments, and repurchase agreements. The ASU establishes additional disclosures presenting the gross amounts of recognized assets and liabilities, offsetting amounts, and the net balance reflected in the statement of financial position. Descriptive information regarding the nature and rights of the offset must also be disclosed.

The Corporation does not expect the adoption of this standard will have a significant impact on its consolidated financial condition or results of operations.

**NOTE B RESTRICTIONS ON CASH AND DUE FROM BANKS**

In return for services obtained through correspondent banks, the Corporation is required to maintain non-interest bearing cash balances in those correspondent banks. At December 31, 2011 and 2010, compensating balances approximated \$2,085,000 and \$2,564,000, respectively. During 2011 and 2010, average compensating balances approximated \$2,611,000 and \$2,559,000, respectively. All compensating balances are met by vault cash.

Table of Contents**NOTE C SECURITIES**

Amortized cost and fair value at December 31, 2011 and 2010, were as follows:

| In thousands                         | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--------------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| <b>SECURITIES AVAILABLE FOR SALE</b> |                   |                              |                               |               |
| <b>December 31, 2011</b>             |                   |                              |                               |               |
| U.S. Government and agencies         | \$ 39,237         | \$ 932                       | \$                            | \$ 40,169     |
| Mortgage-backed securities           | 102,059           | 5,473                        | 5                             | 107,527       |
| State and municipal                  | 44,072            | 2,250                        | 5                             | 46,317        |
| Corporate bonds                      | 13,105            | 304                          | 30                            | 13,379        |
| CRA mutual fund                      | 1,044             | 37                           |                               | 1,081         |
| Stock in other banks                 | 627               | 127                          |                               | 754           |
|                                      | \$ 200,144        | \$ 9,123                     | \$ 40                         | \$ 209,227    |
| <b>December 31, 2010</b>             |                   |                              |                               |               |
| U.S. Government and agencies         | \$ 28,225         | \$ 297                       | \$ 262                        | \$ 28,260     |
| Mortgage-backed securities           | 109,386           | 5,292                        | 319                           | 114,359       |
| State and municipal                  | 34,214            | 643                          | 181                           | 34,676        |
| Corporate bonds                      | 11,303            | 367                          | 11                            | 11,659        |
| CRA mutual fund                      | 1,032             |                              | 2                             | 1,030         |
| Stock in other banks                 | 627               | 119                          |                               | 746           |
|                                      | \$ 184,787        | \$ 6,718                     | \$ 775                        | \$ 190,730    |
| <b>SECURITIES HELD TO MATURITY</b>   |                   |                              |                               |               |
| <b>December 31, 2011</b>             |                   |                              |                               |               |
| U.S. Government and agencies         | \$ 10,032         | \$ 648                       | \$                            | \$ 10,680     |
| <b>December 31, 2010</b>             |                   |                              |                               |               |
| U.S. Government and agencies         | \$ 10,044         | \$ 627                       | \$                            | \$ 10,671     |

Table of Contents**NOTE C SECURITIES (Continued)**

The following table shows the Corporation's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2011 and 2010:

| In thousands                         | Less than 12 Months |                   | 12 Months or More |                   | Total      |                   |
|--------------------------------------|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|                                      | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| <b>SECURITIES AVAILABLE FOR SALE</b> |                     |                   |                   |                   |            |                   |
| <b>December 31, 2011</b>             |                     |                   |                   |                   |            |                   |
| Mortgage-backed securities           | \$ 1,968            | \$ 5              | \$                | \$                | \$ 1,968   | \$ 5              |
| State and municipal                  | 1,251               | 5                 |                   |                   | 1,251      | 5                 |
| Corporate Bonds                      |                     |                   | 970               | 30                | 970        | 30                |
|                                      | \$ 3,219            | \$ 10             | \$ 970            | \$ 30             | \$ 4,189   | \$ 40             |
| <b>December 31, 2010</b>             |                     |                   |                   |                   |            |                   |
| U.S. Government and agencies         | \$ 10,585           | \$ 262            | \$                | \$                | \$ 10,585  | \$ 262            |
| Mortgage-backed securities           | 21,071              | 319               |                   |                   | 21,071     | 319               |
| State and municipal                  | 11,680              | 181               |                   |                   | 11,680     | 181               |
| Corporate Bonds                      | 989                 | 11                |                   |                   | 989        | 11                |
| CRA mutual fund                      | 1,030               | 2                 |                   |                   | 1,030      | 2                 |
|                                      | \$ 45,355           | \$ 775            | \$                | \$                | \$ 45,355  | \$ 775            |

All mortgage-backed security investments are government sponsored enterprise (GSE) pass through instruments issued by the Federal National Mortgage Association (FNMA), Government National Mortgage Association (GNMA) or Federal Home Loan Mortgage Corporation (FHLMC), which guarantee the timely payment of principal on these investments.

At December 31, 2011, one mortgage-backed security had an unrealized loss, and was in the continuous loss position for less than 12 months. This unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the specific security. This security had an unrealized loss of less than 1% of amortized cost.

At December 31, 2011, four state and municipal securities had unrealized losses, and none of the municipal securities had been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of specific securities. None of the securities in this category had an unrealized loss that exceeded 2% of amortized cost.

At December 31, 2011, one corporate bond security had an unrealized loss. This security has been in a continuous loss position for 12 months or more. This unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the specific security. This security had an unrealized loss of less than 3% of amortized cost.

In analyzing the issuer's financial condition, management considers industry analysts' reports, financial performance, and projected target prices of investment analysts within a one-year time frame. Based on the above information, management has determined that none of these investments are other-than-temporarily impaired.

Table of Contents**NOTE C SECURITIES (Continued)**

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the security's relationship to other benchmark quoted prices. The Corporation uses an independent service provider to provide matrix pricing and uses the valuation of another provider to compare for reasonableness.

Management routinely sells securities from its available for sale portfolio in an effort to manage and allocate the portfolio. At December 31, 2011, management had not identified any securities with an unrealized loss that it intends to sell. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the securities, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management's intention and ability to hold the securities until recovery of unrealized losses.

The Corporation holds equity investments in the common stock of two bank holding companies headquartered and operating in Pennsylvania. Both holding companies continue to pay cash dividends, which was one of the driving forces in the original investment decision to purchase those stocks. However, 2009 market prices for these stocks were below the prices paid at the time of acquisition. A review of the factors contributing to the price decline led to a conclusion that the prices on these securities were not likely to recover in the near term and that they were other-than-temporarily impaired. A charge against current earnings of \$522,000 was taken in the third quarter of 2009 to write down the value of these securities to their fair values.

Amortized cost and fair value at December 31, 2011, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

| In thousands                  | Available for Sale |            | Held to Maturity |            |
|-------------------------------|--------------------|------------|------------------|------------|
|                               | Amortized Cost     | Fair Value | Amortized Cost   | Fair Value |
| 1 year or less                | \$ 6,582           | \$ 6,656   | \$               | \$         |
| Over 1 year through 5 years   | 39,908             | 41,141     | 10,032           | 10,680     |
| Over 5 years through 10 years | 39,044             | 40,775     |                  |            |
| Over 10 years                 | 10,880             | 11,293     |                  |            |
| Mortgage-backed securities    | 102,059            | 107,527    |                  |            |
| CRA mutual fund               | 1,044              | 1,081      |                  |            |
| Stock in other banks          | 627                | 754        |                  |            |
|                               | \$ 200,144         | \$ 209,227 | \$ 10,032        | \$ 10,680  |

The Corporation realized gross gains of \$1,000 during 2011, \$128,000 during 2010, and \$75,000 during 2009 and gross losses of \$0 during 2011, \$56,000 during 2010 and \$58,000 during 2009 on sales of securities available for sale. State and municipal securities were sold at a loss in 2010 and 2009 in order to adjust the Corporation's interest rate sensitivity, reduce exposure to geographic locations, balance the mix with other investment types and to reduce risks related to insurance coverage.



Table of Contents**NOTE C SECURITIES (Continued)**

At December 31, 2011 and 2010, securities with a carrying value of \$124,069,000 and \$99,197,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements and for other purposes.

**NOTE D LOANS**

The Bank grants commercial, residential and consumer loans to customers primarily within southcentral Pennsylvania and northern Maryland and the surrounding area. A large portion of the loan portfolio is secured by real estate. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy.

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Corporation's internal risk rating system as of December 31, 2011 and 2010:

| In thousands                        | Pass              | Special<br>Mention | Substandard      | Doubtful  | Total             |
|-------------------------------------|-------------------|--------------------|------------------|-----------|-------------------|
| <b>December 31, 2011</b>            |                   |                    |                  |           |                   |
| Commercial and industrial           | \$ 48,284         | \$ 4,596           | \$ 3,265         | \$        | \$ 56,145         |
| Commercial real estate              | 200,834           | 19,872             | 15,311           |           | 236,017           |
| Commercial real estate construction | 7,400             | 12,743             | 2,614            |           | 22,757            |
| Residential mortgage                | 304,627           | 4,261              | 2,378            |           | 311,266           |
| Home equity lines of credit         | 50,083            | 2,364              | 85               |           | 52,532            |
| Consumer                            | 15,751            |                    |                  |           | 15,751            |
| <b>Total</b>                        | <b>\$ 626,979</b> | <b>\$ 43,836</b>   | <b>\$ 23,653</b> | <b>\$</b> | <b>\$ 694,468</b> |
| <b>December 31, 2010</b>            |                   |                    |                  |           |                   |
| Commercial and industrial           | \$ 43,448         | \$ 5,041           | \$ 4,187         | \$        | \$ 52,676         |
| Commercial real estate              | 193,731           | 14,530             | 17,689           |           | 225,950           |
| Commercial real estate construction | 11,009            | 10,963             | 4,663            |           | 26,635            |
| Residential mortgage                | 289,833           | 2,882              | 4,282            |           | 296,997           |
| Home equity lines of credit         | 46,383            | 2,081              | 393              |           | 48,857            |
| Consumer                            | 14,176            |                    |                  |           | 14,176            |
| <b>Total</b>                        | <b>\$ 598,580</b> | <b>\$ 35,497</b>   | <b>\$ 31,214</b> | <b>\$</b> | <b>\$ 665,291</b> |

The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2011 and 2010:

| In thousands                        | Impaired Loans with Allowance |                                |                      | Impaired Loans with No Allowance |                                |  |
|-------------------------------------|-------------------------------|--------------------------------|----------------------|----------------------------------|--------------------------------|--|
|                                     | Recorded<br>Investment        | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment           | Unpaid<br>Principal<br>Balance |  |
| <b>DECEMBER 31, 2011</b>            |                               |                                |                      |                                  |                                |  |
| Commercial and industrial           | \$ 1,967                      | \$ 3,102                       | \$ 1,085             | \$ 252                           | \$ 1,367                       |  |
| Commercial real estate              | 273                           | 273                            | 43                   | 6,339                            | 7,136                          |  |
| Commercial real estate construction |                               |                                |                      | 2,614                            | 7,192                          |  |
| Residential mortgage                | 88                            | 88                             | 53                   | 1,313                            | 1,638                          |  |
|                                     | \$ 2,328                      | \$ 3,463                       | \$ 1,181             | \$ 10,518                        | \$ 17,333                      |  |

Table of Contents**NOTE D LOANS (Continued)**

| In thousands                        | Impaired Loans with Allowance |                          |                   | Impaired Loans with No Allowance |                          |
|-------------------------------------|-------------------------------|--------------------------|-------------------|----------------------------------|--------------------------|
|                                     | Recorded Investment           | Unpaid Principal Balance | Related Allowance | Recorded Investment              | Unpaid Principal Balance |
| <b>DECEMBER 31, 2010</b>            |                               |                          |                   |                                  |                          |
| Commercial and industrial           | \$ 869                        | \$ 1,869                 | \$ 547            | \$ 68                            | \$ 68                    |
| Commercial real estate              | 4,326                         | 4,326                    | 726               | 3,955                            | 4,184                    |
| Commercial real estate construction | 4,216                         | 7,716                    | 729               | 172                              | 232                      |
| Residential mortgage                | 97                            | 97                       | 57                | 954                              | 1,312                    |
|                                     | \$ 9,508                      | \$ 14,008                | \$ 2,059          | \$ 5,149                         | \$ 5,796                 |

The following table summarizes information in regards to average of impaired loans and related interest income by loan portfolio class:

| In thousands                        | Impaired Loans with Allowance |                 | Impaired Loans with No Allowance |                 |
|-------------------------------------|-------------------------------|-----------------|----------------------------------|-----------------|
|                                     | Average Recorded Investment   | Interest Income | Average Recorded Investment      | Interest Income |
| <b>DECEMBER 31, 2011</b>            |                               |                 |                                  |                 |
| Commercial and industrial           | \$ 1,019                      | \$              | \$ 349                           | \$              |
| Commercial real estate              | 2,324                         |                 | 4,946                            | 44              |
| Commercial real estate construction |                               |                 | 3,463                            |                 |
| Residential mortgage                | 340                           |                 | 1,119                            |                 |
|                                     | \$ 3,683                      | \$              | \$ 9,877                         | \$ 44           |

| In thousands                        | Impaired Loans with Allowance |                 | Impaired Loans with No Allowance |                 |
|-------------------------------------|-------------------------------|-----------------|----------------------------------|-----------------|
|                                     | Average Recorded Investment   | Interest Income | Average Recorded Investment      | Interest Income |
| <b>DECEMBER 31, 2010</b>            |                               |                 |                                  |                 |
| Commercial and industrial           | \$ 904                        | \$              | \$ 66                            | \$              |
| Commercial real estate              | 1,166                         | 6               | 3,661                            | 29              |
| Commercial real estate construction | 4,882                         | 61              | 562                              |                 |
| Residential mortgage                | 24                            |                 | 1,339                            | 4               |
|                                     | \$ 6,976                      | \$ 67           | \$ 5,628                         | \$ 33           |

The following table presents nonaccrual loans by classes of the loan portfolio as of December 31, 2011 and 2010:

| In thousands                        | 2011             | 2010             |
|-------------------------------------|------------------|------------------|
| Commercial and industrial           | \$ 2,219         | \$ 937           |
| Commercial real estate              | 6,612            | 8,281            |
| Commercial real estate construction | 2,614            | 4,388            |
| Residential mortgage                | 1,401            | 1,051            |
| <b>Total</b>                        | <b>\$ 12,846</b> | <b>\$ 14,657</b> |



Table of Contents**NOTE D LOANS (Continued)**

The following table summarizes information in regards to troubled debt restructurings at December 31, 2011 and 2010:

| In thousands                        | Pre-Modification<br>Outstanding Recorded<br>Investments | Post-Modification<br>Outstanding Recorded<br>Investments | Recorded Investment |
|-------------------------------------|---|--|---------------------|
| <b>December 31, 2011</b>            |   |  |                     |
| Commercial and industrial           | \$ 490  | \$ 485   | \$ 234              |
| Commercial real estate              | \$ 656  | \$ 656   | \$ 412              |
| Commercial real estate construction | \$ 1,548  | \$ 1,541   | \$ 850              |
| <b>December 31, 2010</b>            |   |  |                     |
| Commercial and industrial           | \$ 490  | \$ 485   | \$ 439              |
| Commercial real estate              | \$ 371  | \$ 373   | \$ 168              |
| Commercial real estate construction | \$ 1,548  | \$ 1,541   | \$ 1,536            |

All of the Corporation's troubled debt restructured loans are also nonaccrual impaired loans, which resulted in a specific allocation and, subsequently, a charge-off as appropriate. As of December 31, 2011, charge-offs associated with troubled debt restructured loans while under a forbearance agreement totaled \$589,000. As of December 31, 2011, there were no defaulted troubled debt restructures as all troubled debt restructured loans were current with respect to their associated forbearance agreements. One forbearance agreement was negotiated during 2009 and modified during 2011, two were negotiated during 2010, while the other one was negotiated during 2011.

There are forbearance agreements on all loans currently classified as troubled debt restructures, and all of these agreements have resulted in additional principal repayment. The terms of these forbearance agreements vary whereby principal payments have been decreased, interest rates have been reduced, and/or the loan will be repaid as collateral is sold.

As a result of adopting the amendments in Accounting Standards Update No. 2011-02, the Corporation reassessed all troubled debt restructurings that occurred on or after January 1, 2011, for identification as troubled debt restructurings. The Corporation identified no loans for which the allowance for loan losses had previously been measured under a general allowance of credit losses methodology that are now considered troubled debt restructurings in accordance with Accounting Standards Update No. 2011-02.

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due.

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**NOTE D LOANS (Continued)**

The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2011 and 2010:

| In thousands                           | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater<br>Than<br>90 Days | Total Past<br>Due | Current           | Total Loans<br>Receivable | Loans<br>Receivable<br>>90 Days<br>and<br>Accruing |
|--|---------------------------|---------------------------|----------------------------|-------------------|-------------------|---------------------------|--|
| <b>December 31, 2011</b>               |                           |                           |                            |                   |                   |                           |  |
| Commercial and industrial              | \$ 25                     | \$ 14                     | \$ 2,219                   | \$ 2,258          | \$ 53,887         | \$ 56,145                 | \$   |
| Commercial real estate                 | 329                       | 4,184                     | 6,663                      | 11,176            | 224,841           | 236,017                   | 51   |
| Commercial real estate<br>construction |                           |                           | 2,614                      | 2,614             | 20,143            | 22,757                    |  |
| Residential mortgage                   | 4,585                     | 1,395                     | 2,378                      | 8,358             | 302,908           | 311,266                   | 977  |
| Home equity lines of<br>credit         | 397                       |                           | 163                        | 560               | 51,972            | 52,532                    | 163  |
| Consumer                               | 20                        | 8                         |                            | 28                | 15,723            | 15,751                    |  |
| <b>Total</b>                           | <b>\$ 5,356</b>           | <b>\$ 5,601</b>           | <b>\$ 14,037</b>           | <b>\$ 24,994</b>  | <b>\$ 669,474</b> | <b>\$ 694,468</b>         | <b>\$ 1,191</b>                                    |

| In thousands                           | 30-59<br>Days<br>Past Due | 60-89<br>Days<br>Past Due | Greater<br>Than<br>90 Days | Total Past<br>Due | Current           | Total<br>Loans<br>Receivable | Loans<br>Receivable<br>>90 Days<br>and<br>Accruing |
|--|---------------------------|---------------------------|----------------------------|-------------------|-------------------|------------------------------|--|
| <b>December 31, 2010</b>               |                           |                           |                            |                   |                   |                              |  |
| Commercial and industrial              | \$ 105                    | \$                        | \$ 937                     | \$ 1,042          | \$ 51,634         | \$ 52,676                    | \$   |
| Commercial real estate                 | 1,903                     | 744                       | 8,281                      | 10,928            | 215,022           | 225,950                      |  |
| Commercial real estate<br>construction |                           |                           | 4,388                      | 4,388             | 22,247            | 26,635                       |  |
| Residential mortgage                   | 3,182                     | 492                       | 2,035                      | 5,709             | 291,288           | 296,997                      | 984  |
| Home equity lines of credit            | 115                       | 13                        | 13                         | 141               | 48,716            | 48,857                       | 13   |
| Consumer                               | 16                        |                           |                            | 16                | 14,160            | 14,176                       |  |
| <b>Total</b>                           | <b>\$ 5,321</b>           | <b>\$ 1,249</b>           | <b>\$ 15,654</b>           | <b>\$ 22,224</b>  | <b>\$ 643,067</b> | <b>\$ 665,291</b>            | <b>\$ 997</b>                                      |

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**NOTE D LOANS (Continued)**

The following table summarizes the allowance for loan losses and recorded investment in financing receivables:

| In thousands  | Commercial and Industrial | Commercial Real Estate | Commercial Real Estate Construction | Residential Mortgage | Home Equity Lines of Credit | Consumer  | Unallocated | Total      |
|---|---------------------------|------------------------|-------------------------------------|----------------------|-----------------------------|-----------|-------------|------------|
| <b>December 31, 2011</b>                              |                           |                        |                                     |                      |                             |           |             |            |
| <b>Allowance for loan losses</b>                      |                           |                        |                                     |                      |                             |           |             |            |
| Beginning balance- January 1, 2011                    | \$ 2,074                  | \$ 6,346               | \$ 1,154                            | \$ 3,108             | \$ 341                      | \$ 520    | \$ 1,709    | \$ 15,252  |
| Charge offs   | (1,861)                   | (1,308)                | (1,242)                             | (750)                | (52)                        | (30)      |             | (5,243)    |
| Recoveries  | 34                        |                        |                                     | 2                    |                             | 2         |             | 38         |
| Provisions  | 2,335                     | 969                    | 636                                 | 1,264                | 218                         | (73)      | 86          | 5,435      |
| Ending balance- December 31, 2011                     | \$ 2,582                  | \$ 6,007               | \$ 548                              | \$ 3,624             | \$ 507                      | \$ 419    | \$ 1,795    | \$ 15,482  |
| Ending balance: individually evaluated for impairment | \$ 1,085                  | \$ 43                  | \$                                  | \$ 53                | \$                          | \$        | \$          | \$ 1,181   |
| Ending balance: collectively evaluated for impairment | \$ 1,497                  | \$ 5,964               | \$ 548                              | \$ 3,571             | \$ 507                      | \$ 419    | \$ 1,795    | \$ 14,301  |
| <b>Loans receivables</b>                              |                           |                        |                                     |                      |                             |           |             |            |
| Ending balance  | \$ 56,145                 | \$ 236,017             | \$ 22,757                           | \$ 311,266           | \$ 52,532                   | \$ 15,751 | \$          | \$ 694,468 |
| Ending balance: individually evaluated for impairment | \$ 2,219                  | \$ 6,612               | \$ 2,614                            | \$ 1,401             | \$                          | \$        | \$          | \$ 12,846  |
| Ending balance: collectively evaluated for impairment | \$ 53,926                 | \$ 229,405             | \$ 20,143                           | \$ 309,865           | \$ 52,532                   | \$ 15,751 | \$          | \$ 681,622 |

| In thousands  | Commercial and Industrial | Commercial Real Estate | Commercial Real Estate Construction | Residential Mortgage | Home Equity Lines of Credit | Consumer  | Unallocated | Total      |
|---|---------------------------|------------------------|-------------------------------------|----------------------|-----------------------------|-----------|-------------|------------|
| <b>December 31, 2010</b>                              |                           |                        |                                     |                      |                             |           |             |            |
| <b>Allowance for loan losses</b>                      |                           |                        |                                     |                      |                             |           |             |            |
| Ending balance  | \$ 2,074                  | \$ 6,346               | \$ 1,154                            | \$ 3,108             | \$ 341                      | \$ 520    | \$ 1,709    | \$ 15,252  |
| Ending balance: individually evaluated for impairment | \$ 547                    | \$ 726                 | \$ 729                              | \$ 57                | \$                          | \$        | \$          | \$ 2,059   |
| Ending balance: collectively evaluated for impairment | \$ 1,527                  | \$ 5,620               | \$ 425                              | \$ 3,051             | \$ 341                      | \$ 520    | \$ 1,709    | \$ 13,193  |
| <b>Loans receivables</b>                              |                           |                        |                                     |                      |                             |           |             |            |
| Ending balance  | \$ 52,676                 | \$ 225,950             | \$ 26,635                           | \$ 296,997           | \$ 48,857                   | \$ 14,176 | \$          | \$ 665,291 |
| Ending balance: individually evaluated for impairment | \$ 937                    | \$ 8,281               | \$ 4,388                            | \$ 1,051             | \$                          | \$        | \$          | \$ 14,657  |
| Ending balance: collectively evaluated for impairment | \$ 51,739                 | \$ 217,669             | \$ 22,247                           | \$ 295,946           | \$ 48,857                   | \$ 14,176 | \$          | \$ 650,634 |

Changes in the allowance for loan losses were as follows:

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| In thousands                    | Years Ended December 31, |           |           |
|---------------------------------|--------------------------|-----------|-----------|
|                                 | 2011                     | 2010      | 2009      |
| Balance, beginning              | \$ 15,252                | \$ 11,981 | \$ 7,393  |
| Provision charged to operations | 5,435                    | 6,410     | 4,750     |
| Recoveries on charged-off loans | 38                       | 42        | 186       |
| Loans charged-off               | (5,243)                  | (3,181)   | (348)     |
| Balance, ending                 | \$ 15,482                | \$ 15,252 | \$ 11,981 |

If interest on all nonaccrual loans had been accrued at original contract rates, interest income would have increased by \$652,000 in 2011, \$464,000 in 2010, and \$643,000 in 2009.

Table of Contents**NOTE D LOANS (Continued)**

The following is a summary of information pertaining to impaired loans at December 31:

| In thousands                                 | Years Ended December 31, |           |           |
|--|--------------------------|-----------|-----------|
|  | 2011                     | 2010      | 2009      |
| Average investment in impaired loans         | \$ 13,560                | \$ 12,604 | \$ 11,245 |
| Interest income recognized on impaired loans | \$ 44                    | \$ 100    | \$ 218    |

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

**NOTE E PREMISES AND EQUIPMENT**

Premises and equipment at December 31 were as follows:

| In thousands               | 2011      | 2010      |
|----------------------------|-----------|-----------|
| Land                       | \$ 1,791  | \$ 1,323  |
| Buildings and improvements | 16,826    | 16,014    |
| Furniture and equipment    | 11,737    | 11,410    |
| Assets in process          | 267       | 149       |
|                            | 30,621    | 28,896    |
| Accumulated depreciation   | (16,138)  | (14,777)  |
|                            | \$ 14,483 | \$ 14,119 |

Depreciation expense was \$1,578,000, \$1,701,000 and \$1,644,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

**NOTE F INVESTMENTS IN LOW-INCOME HOUSING PARTNERSHIPS**

ACNB Corporation is a limited partner in five partnerships, whose purpose is to develop, manage and operate residential low-income properties. At December 31, 2011 and 2010, the carrying value of these investments was approximately \$3,774,000 and \$4,124,000, respectively.

**NOTE G DEPOSITS**

Deposits were comprised of the following as of December 31:

| In thousands  | 2011       | 2010       |
|---|------------|------------|
| Non-interest bearing demand                         | \$ 112,247 | \$ 103,464 |
| Interest bearing demand                             | 114,112    | 108,851    |
| Savings   | 266,560    | 241,904    |
| Time certificates of deposit less than \$100,000    | 208,894    | 218,833    |
| Time certificates of deposit greater than \$100,000 | 80,982     | 73,474     |
|   | \$ 782,795 | \$ 746,526 |



Table of Contents**NOTE G DEPOSITS (Continued)**

Scheduled maturities of time certificates of deposit at December 31, 2011, were as follows:

| <b>Years Ending</b> | <b>In thousands</b> |
|---------------------|---------------------|
| 2012                | \$ 172,158          |
| 2013                | 99,241              |
| 2014                | 10,711              |
| 2015                | 5,258               |
| 2016                | 2,508               |
|                     | \$ 289,876          |

**NOTE H LEASE COMMITMENTS**

Certain branch offices and equipment are leased under agreements which expire at varying dates through 2021. Most leases contain renewal provisions at the Corporation's option. The total rental expense for all operating leases was \$405,000, \$462,000 and \$489,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

The following is a schedule by year of future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31:

| <b>Years Ending</b> | <b>In thousands</b> |
|---------------------|---------------------|
| 2012                | \$ 385              |
| 2013                | 380                 |
| 2014                | 355                 |
| 2015                | 322                 |
| 2016                | 226                 |
| Later years         | 354                 |
|                     | \$ 2,022            |

ACNB leases space at several of its owned offices to other unrelated organizations under agreements that expire at varying dates from 2012 to 2014. Most leases contain renewal provisions at the option of the lessee. Total rental income for these properties was \$130,000, \$123,000 and \$122,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

**NOTE I BORROWINGS**

Short-term borrowings and weighted-average interest rates at December 31 are as follows:

| <b>Dollars in thousands</b>                 | <b>2011</b>   |             | <b>2010</b>   |             |
|---|---------------|-------------|---------------|-------------|
|   | <b>Amount</b> | <b>Rate</b> | <b>Amount</b> | <b>Rate</b> |
| Treasury tax and loan note                  | \$            | 0.00%       | \$ 1,823      | 0.00%       |
| Securities sold under repurchase agreements | 45,962        | 0.20%       | 37,263        | 0.24%       |
|   | \$ 45,962     | 0.20%       | \$ 39,086     | 0.23%       |

Under an agreement with the FHLB, the Bank has short-term borrowing capacity included in the maximum borrowing capacity. All FHLB advances are collateralized by a security agreement covering qualifying loans and unpledged U.S. Treasury, agency and mortgage-backed securities. In addition, all

Table of Contents**NOTE I BORROWINGS (Continued)**

FHLB advances are secured by the FHLB capital stock owned by the Bank having a par value of \$6,848,000 at December 31, 2011. The Corporation also has lines of credit that total \$15,000,000 with correspondent banks for overnight federal funds borrowings.

The Corporation offers a short-term investment program for corporate customers for secured investing. This program consists of overnight and short-term repurchase agreements that are secured by designated investment securities owned by the Corporation. The investment securities are under the control of the Corporation.

A summary of long-term debt as of December 31 is as follows:

| Dollars in thousands                   | 2011             |              | 2010             |              |
|--|------------------|--------------|------------------|--------------|
|  | Amount           | Rate         | Amount           | Rate         |
| FHLB fixed-rate advances maturing:     |                  |              |                  |              |
| 2011                                   | \$               | %            | 10,000           | 2.92%        |
| 2012                                   | 11,000           | 4.14%        | 11,000           | 4.14%        |
| 2013                                   | 14,000           | 2.55%        | 14,000           | 2.55%        |
| 2014                                   | 11,000           | 3.31%        | 11,000           | 3.31%        |
| 2015                                   | 12,000           | 3.87%        | 12,000           | 3.87%        |
| 2016                                   | 5,000            | 4.52%        | 5,000            | 4.52%        |
| 2017                                   | 4,000            | 4.86%        | 4,000            | 4.86%        |
| 2018                                   | 2,000            | 5.11%        | 2,000            | 5.11%        |
| FHLB convertible advance maturing 2012 | 10,000           | 4.27%        | 10,000           | 4.27%        |
| Loan payable to local bank             | 2,191            | 6.35%        | 2,499            | 6.50%        |
|  | <b>\$ 71,191</b> | <b>3.83%</b> | <b>\$ 81,499</b> | <b>3.74%</b> |

The FHLB advances are collateralized by the assets defined in security agreement and FHLB capital stock described previously. The Corporation can borrow a maximum of \$297,282,000 from the FHLB, of which \$228,282,000 was available at December 31, 2011. The FHLB has the option to convert the \$10,000,000 convertible advance, but not before three-month LIBOR reaches 8%. Upon the FHLB's conversion, the Bank has the option to repay the advance in full.

The loan payable to a local bank is payable in monthly installments of \$29,472 and matures in April 2016. The loan is unsecured.

**NOTE J REGULATORY RESTRICTIONS ON DIVIDENDS**

Dividend payments by the Bank to the Corporation are subject to the Pennsylvania Banking Code, the Federal Deposit Insurance Act, and the regulations of the FDIC. Under the Banking Code, no dividends may be paid except from "accumulated net earnings" (generally, retained earnings). The Federal Reserve Board and the FDIC have formal and informal policies which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings, with some exceptions. As of December 31, 2011, \$8,388,000 of undistributed earnings of the Bank, included in consolidated retained earnings, was available for distribution to the Corporation as dividends without prior regulatory approval. Additionally, dividends paid by the Bank to the Corporation would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

Table of Contents**NOTE K INCOME TAXES**

The components of income tax expense (benefit) for the years ended December 31, 2011, 2010 and 2009, are as follows:

| In thousands | 2011            | 2010     | 2009     |
|--------------|-----------------|----------|----------|
| Federal:     |                 |          |          |
| Current      | \$ 1,816        | \$ 722   | \$ 2,942 |
| Deferred     | 279             | 1,296    | (1,647)  |
|              | <b>2,095</b>    | 2,018    | 1,295    |
| State:       |                 |          |          |
| Current      | 59              | 39       | 62       |
|              | <b>\$ 2,154</b> | \$ 2,057 | \$ 1,357 |

Reconciliations of the statutory federal income tax at a rate of 34% to the income tax expense reported in the consolidated statements of income for the years ended December 31, 2011, 2010 and 2009, are as follows:

|   | Percentage of Income<br>before Income Taxes |        |        |
|---|---|--------|--------|
|   | 2011  | 2010   | 2009   |
| Federal income tax at statutory rate          | 34.0%                                       | 34.0%  | 34.0%  |
| State income taxes, net of federal benefit    | 0.4%  | 0.4%   | 0.5%   |
| Tax-exempt income                             | (6.0)%                                      | (5.8)% | (6.9)% |
| Earnings on investment in life insurance      | (3.1)%                                      | (3.5)% | (4.0)% |
| Rehabilitation and low-income housing credits | (5.2)%                                      | (5.5)% | (7.9)% |
| Other   | 0.1%  | 0.1%   | 0.1%   |
|   | <b>20.2%</b>                                | 19.7%  | 15.8%  |

The provision for federal income taxes includes \$0, \$24,000 and \$6,000 of income taxes related to net gains on sales of securities in 2011, 2010 and 2009, respectively. Rehabilitation and low-income housing income tax credits were \$556,000, \$578,000, and \$679,000 during 2011, 2010 and 2009, respectively. Projected credits are \$556,000 in 2012, \$405,000 in 2013, and \$372,000 thereafter.

Table of Contents**NOTE K INCOME TAXES (Continued)**

Components of deferred tax assets and liabilities at December 31 were as follows:

| In thousands                               | 2011            | 2010            |
|--|-----------------|-----------------|
| Deferred tax assets:                       |                 |                 |
| Allowance for loan losses                  | \$ 5,264        | \$ 5,152        |
| Accrued deferred compensation              | 664             | 672             |
| Pension                                    | 2,751           | 1,412           |
| Deferred loan fees                         | 35              | 70              |
| Other than temporary impairment            | 178             | 178             |
| Low income housing tax credit carryforward | 447             | 385             |
| Non-accrual interest                       | 230             | 224             |
| Director deferred liability                | 300             | 221             |
| Other                                      | 382             | 172             |
|  | <b>10,251</b>   | 8,486           |
| Deferred tax liabilities:                  |                 |                 |
| Available for sale securities              | 3,088           | 2,021           |
| Prepaid pension benefit cost               | 4,268           | 3,398           |
| Prepaid expenses                           | 281             | 316             |
| Accumulated depreciation                   | 540             | 574             |
| Goodwill/intangibles                       | 627             | 723             |
|  | <b>8,804</b>    | 7,032           |
| <b>Net Deferred Tax Asset</b>              | <b>\$ 1,447</b> | <b>\$ 1,454</b> |

The Corporation has a federal tax credit carryforward related to low income housing credits that expires in 2030.

The Corporation did not have any uncertain tax positions at December 31, 2011 and 2010. The Corporation's policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense in the Consolidated Statements of Income.

Years that remain open for potential review by the Internal Revenue Service are 2008 through 2010.

**NOTE L FAIR VALUE MEASUREMENTS**

Management uses its best judgment in estimating the fair value of the Corporation's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Corporation could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective reporting dates and have not been reevaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period end.

Fair value measurement and disclosure guidance defines fair value as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.

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**NOTE L FAIR VALUE MEASUREMENTS (Continued)**

Fair value measurement and disclosure guidance provides a list of factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with fair value measurement and disclosure guidance.

This guidance further clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

Fair value measurement and disclosure guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Table of Contents**NOTE L FAIR VALUE MEASUREMENTS (Continued)**

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis on measurement used at December 31, 2011 and 2010, are as follows:

| Fair Value Measurements at December 31, 2011 |                      |                   |                 |                   |              |
|--|----------------------|-------------------|-----------------|-------------------|--------------|
| In thousands                                 | Basis                | Total             | Level 1         | Level 2           | Level 3      |
| U.S. Government and agencies                 |                      | \$ 40,169         | \$              | \$ 40,169         | \$           |
| Mortgage-backed securities                   |                      | 107,527           |                 | 107,527           |              |
| State and municipal                          |                      | 46,317            |                 | 46,317            |              |
| Corporate bonds                              |                      | 13,379            |                 | 13,379            |              |
| CRA mutual fund                              |                      | 1,081             | 1,081           |                   |              |
| Stock in other banks                         |                      | 754               | 754             |                   |              |
| <b>Total securities available for sale</b>   | <b>Recurring</b>     | <b>\$ 209,227</b> | <b>\$ 1,835</b> | <b>\$ 207,392</b> | <b>\$</b>    |
| Impaired loans                               | <b>Non-recurring</b> | <b>8,075</b>      |                 |                   | <b>8,075</b> |
| Foreclosed assets held for resale            | <b>Non-recurring</b> | <b>1,176</b>      |                 |                   | <b>1,176</b> |

| Fair Value Measurements at December 31, 2010 |                      |                   |                 |                   |              |
|--|----------------------|-------------------|-----------------|-------------------|--------------|
| In thousands                                 | Basis                | Total             | Level 1         | Level 2           | Level 3      |
| U.S. Government and agencies                 |                      | \$ 28,260         | \$              | \$ 28,260         | \$           |
| Mortgage-backed securities                   |                      | 114,359           |                 | 114,359           |              |
| State and municipal                          |                      | 34,676            |                 | 34,676            |              |
| Corporate bonds                              |                      | 11,659            |                 | 11,659            |              |
| CRA mutual fund                              |                      | 1,030             | 1,030           |                   |              |
| Stock in other banks                         |                      | 746               | 746             |                   |              |
| <b>Total securities available for sale</b>   | <b>Recurring</b>     | <b>\$ 190,730</b> | <b>\$ 1,776</b> | <b>\$ 188,954</b> | <b>\$</b>    |
| Impaired loans                               | <b>Non-recurring</b> | <b>8,504</b>      |                 |                   | <b>8,504</b> |
| Foreclosed assets held for resale            | <b>Non-recurring</b> | <b>518</b>        |                 |                   | <b>518</b>   |

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Corporation's financial instruments at December 31, 2011 and 2010:

**Cash and Cash Equivalents (Carried at Cost)**

The carrying amounts reported in the consolidated statement of condition for cash and short-term instruments approximate those assets' fair value.

**Securities**

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the security's relationship to other benchmark quoted prices. The Corporation uses an independent service provider to provide matrix pricing and uses the valuation of another provider to compare for reasonableness.

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**NOTE L FAIR VALUE MEASUREMENTS (Continued)**

**Loans Held for Sale (Carried at Lower of Cost or Fair Value)**

The fair values of mortgage loans held for sale are determined based on amounts to be received at settlement by establishing the respective buyer requirement or market interest rates.

**Loans (Carried at Cost)**

The fair values of loans are estimated using discounted cash flow analyses, as well as using market rates at the balance sheet date that reflect the credit and interest rate risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments, and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

**Impaired Loans (Generally Carried at Fair Value)**

Loans for which the Corporation has measured impairment are generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value consists of the loan balances less the valuation allowance.

**Foreclosed Assets Held for Resale**

Fair value of real estate acquired through foreclosure is based on independent third-party appraisals of the properties. These assets are included as Level 3 fair values, based on appraisals that consider the sales prices of similar properties in the proximate vicinity.

**Restricted Investment in Bank Stock (Carried at Cost)**

The carrying amount of required and restricted investment in correspondent bank stock approximates fair value, and considers the limited marketability of such securities.

**Accrued Interest Receivable and Payable (Carried at Cost)**

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

**Deposits (Carried at Cost)**

The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (e.g., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

**Short-Term Borrowings (Carried at Cost)**

The carrying amounts of short-term borrowings approximate their fair values.

**Long-Term Borrowings (Carried at Cost)**

Fair values of Federal Home Loan Bank (FHLB) advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics,

Table of Contents**NOTE L FAIR VALUE MEASUREMENTS (Continued)**

terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

**Off-Balance Sheet Credit-Related Instruments**

Fair values for the Corporation's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

Estimated fair values of financial instruments at December 31 were as follows:

| In thousands                            | 2011            |            | 2010            |            |
|---|-----------------|------------|-----------------|------------|
|   | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| <b>Financial assets:</b>                |                 |            |                 |            |
| Cash and due from banks                 | \$ 14,423       | \$ 14,423  | \$ 14,091       | \$ 14,091  |
| Interest bearing deposits in banks      | 8,200           | 8,200      | 10,082          | 10,082     |
| <b>Investment securities</b>            |                 |            |                 |            |
| Available for sale                      | 209,227         | 209,227    | 190,730         | 190,730    |
| Held to maturity                        | 10,032          | 10,680     | 10,044          | 10,671     |
| Loans held for sale                     | 337             | 337        | 3,068           | 3,068      |
| Loans, less allowance for loan losses   | 678,986         | 710,671    | 650,039         | 665,253    |
| Accrued interest receivable             | 3,674           | 3,674      | 3,417           | 3,417      |
| Restricted investment in bank stocks    | 7,146           | 7,146      | 8,420           | 8,420      |
| <b>Financial liabilities:</b>           |                 |            |                 |            |
| Deposits                                | 782,795         | 784,784    | 746,526         | 750,068    |
| Short-term borrowings                   | 45,962          | 45,962     | 39,086          | 39,086     |
| Long-term borrowings                    | 71,191          | 75,792     | 81,499          | 85,772     |
| Accrued interest payable                | 1,429           | 1,429      | 1,667           | 1,667      |
| Off-balance sheet financial instruments |                 |            |                 |            |

**NOTE M RETIREMENT PLANS**

The Corporation's banking subsidiary has a non-contributory, defined benefit pension plan. Retirement benefits are a function of both years of service and compensation. The funding policy is to contribute annually the amount that is sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act.



Table of Contents**NOTE M RETIREMENT PLANS (Continued)**

A measurement date of December 31 has been used for the fiscal year ending December 31, 2011 and 2010.

| <b>In thousands</b>  | <b>2011</b>     | <b>2010</b> |
|--|-----------------|-------------|
| <b>Change in benefit obligation:</b>                                     |                 |             |
| Benefit obligation at beginning of year                                  | \$ 17,919       | \$ 18,283   |
| Service cost   | 570             | 458         |
| Interest cost  | 962             | 1,074       |
| Actuarial (gain) loss  | 2,303           | (1,153)     |
| Benefits paid  | (765)           | (743)       |
| <b>Benefit obligation at end of year</b>                                 | <b>20,989</b>   | 17,919      |
| <b>Change in plan assets:</b>  |                 |             |
| Fair value of plan assets at beginning of year                           | 23,760          | 15,618      |
| Actual return on plan assets   | 1               | 2,335       |
| Employer contribution  | 2,455           | 6,550       |
| Benefits paid  | (765)           | (743)       |
| <b>Fair value of plan assets at end of year</b>                          | <b>25,451</b>   | 23,760      |
| <b>Funded Status, included in other assets</b>                           | <b>\$ 4,462</b> | \$ 5,841    |
| <b>Amounts recognized in accumulated other comprehensive income:</b>     |                 |             |
| Total net actuarial loss   | \$ 7,937        | \$ 3,947    |
| Transition obligation  | 10              | 22          |
| Prior service cost   | 144             | 184         |
| <b>Total included in accumulated other comprehensive income (pretax)</b> | <b>\$ 8,091</b> | \$ 4,153    |

The estimated costs that will be amortized from accumulated other comprehensive income into net periodic pension cost during the next fiscal year are as follows:

| <b>In thousands</b>      |        |
|--------------------------|--------|
| Net loss                 | \$ 611 |
| Prior service cost       | 40     |
| Net transition liability | 10     |
|                          | \$ 661 |

The accumulated benefit obligation totaled \$20,658,000 and \$17,755,000 at December 31, 2011 and 2010, respectively.

Table of Contents**NOTE M RETIREMENT PLANS (Continued)**

The components of net periodic benefit costs (income) related to the non-contributory, defined benefit pension plan for the years ended December 31 are as follows:

| In thousands                                      | 2011            | 2010          | 2009            |
|---|-----------------|---------------|-----------------|
| Components of net periodic benefit cost (income): |                 |               |                 |
| Service cost                                      | \$ 570          | \$ 458        | \$ 561          |
| Interest cost                                     | 962             | 1,074         | 989             |
| Expected return on plan assets                    | (1,829)         | (1,216)       | (964)           |
| Recognized net actuarial loss                     | 140             | 436           | 579             |
| Amortization of transition liability              | 12              | 12            | 12              |
| Amortization of prior service cost                | 40              | 39            | 39              |
| <b>Net Periodic Benefit Cost (Income)</b>         | <b>\$ (105)</b> | <b>\$ 803</b> | <b>\$ 1,216</b> |

For the years ended December 31, 2011, 2010 and 2009, the assumptions used to determine the benefit obligation are as follows:

|                               | 2011  | 2010  | 2009  |
|-------------------------------|-------|-------|-------|
| Discount rate                 | 4.50% | 5.50% | 6.00% |
| Rate of compensation increase | 4.00% | 3.58% | 3.55% |

For the years ended December 31, 2011, 2010 and 2009, the assumptions used to determine the net periodic benefit cost (income) are as follows:

|  | 2011  | 2010  | 2009  |
|--|-------|-------|-------|
| Discount rate                                    | 5.50% | 6.00% | 6.00% |
| Expected long-term rate of return on plan assets | 7.50% | 7.75% | 7.75% |
| Rate of compensation increase                    | 3.58% | 3.55% | 3.58% |

The Corporation's pension plan weighted-average assets' allocations at December 31, 2011 and 2010, are as follows:

|                         | 2011 | 2010 |
|-------------------------|------|------|
| Equity securities       | 44%  | 43%  |
| Debt securities         | 42%  | 35%  |
| Short-term fixed income | 8%   | 18%  |
| Real estate             | 6%   | 4%   |
|                         | 100% | 100% |

Table of Contents**NOTE M RETIREMENT PLANS (Continued)**

The Corporation's overall investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of assets types, fund strategies and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation's risk tolerance on contribution levels, funded status and plan expense, and any applicable regulatory requirements. The weighted-average assets' allocation in the above table represents the Corporation's conclusion on the appropriate mix of investments. The specific investment vehicles are institutional separate accounts from a variety of fund managers which are regularly reviewed by the Corporation for acceptable performance.

Equity securities included Corporation common stock in amounts of \$786,000, 3% of total plan assets, and \$849,000, 4% of total plan assets, at December 31, 2011 and 2010, respectively.

Fair value measurements at December 31, 2011, are as follows:

| In thousands      | Total     | Level 1 | Level 2   | Level 3 |
|-------------------|-----------|---------|-----------|---------|
| Equity securities | \$ 11,814 | \$ 786  | \$ 11,028 | \$      |
| Debt securities   | 12,316    |         | 12,316    |         |
| Real estate       | 1,320     |         | 1,320     |         |

Fair value measurements at December 31, 2010, are as follows:

| In thousands      | Total     | Level 1 | Level 2   | Level 3 |
|-------------------|-----------|---------|-----------|---------|
| Equity securities | \$ 15,012 | \$ 849  | \$ 14,163 | \$      |
| Debt securities   | 8,217     |         | 8,217     |         |
| Real estate       | 531       |         |           | 531     |

The following table summarizes the effect the Level 3 investments had on the plan's current year financial activity:

| In thousands              | Real Estate |
|---------------------------|-------------|
| Balance January 1, 2011   | \$ 531      |
| Total gains               | 15          |
| Transfer out of Level 3   | (546)       |
| Balance December 31, 2011 | \$          |
| Balance January 1, 2010   | \$ 458      |
| Total gains               | 73          |
| Balance December 31, 2010 | \$ 531      |

It has not yet been determined the amount the Bank plans on contributing to the Plan in 2012. The Corporation reduced the benefit formula for the defined benefit pension plan effective January 1, 2010, in order to manage total benefit costs. The new formula is the earned benefit as of December 31, 2009, plus 0.75% of a participant's average monthly pay multiplied by years of benefit service earned on and after January 1, 2010, but not more than 25 years. The benefit percentage factor and maximum years of service eligible were both reduced.

Table of Contents**NOTE M RETIREMENT PLANS (Continued)**

Based on current data and assumptions, the following benefit payments, which reflect expected future service, as appropriate, are:

| <b>Years Ending</b> | <b>In thousands</b> |
|---------------------|---------------------|
| 2012                | \$ 880              |
| 2013                | 900                 |
| 2014                | 970                 |
| 2015                | 1,100               |
| 2016                | 1,020               |
| 2017-2021           | 6,620               |

The Corporation's banking subsidiary maintains a 401(k) plan for the benefit of eligible employees. Employees may contribute up to 100% of their compensation subject to certain limits based on federal tax laws. The Bank makes matching contributions up to 100% of the first 4% of an employee's compensation contributed to the plan. Matching contributions vest immediately to the employee. Bank contributions to and expenses for the plan were \$461,000, \$432,000 and \$435,000 for 2011, 2010 and 2009, respectively.

The Corporation's banking subsidiary maintains non-qualified compensation plans for selected senior officers. The estimated present value of future benefits is accrued over the period from the effective date of the agreements until the expected retirement dates of the individuals. The balance accrued for these plans included in other liabilities as of December 31, 2011 and 2010, totaled \$1,372,000 and \$1,326,000, respectively. The annual expense included in salaries and benefits expense totaled \$143,000, \$152,000 and \$146,000 during the years ended December 31, 2011, 2010 and 2009, respectively. To fund the benefits under these plans, the Bank is the owner of single premium life insurance policies on participants in the non-qualified retirement plans. At December 31, 2011 and 2010, the cash surrender value of these policies was \$4,365,000 and \$4,226,000, respectively.

**NOTE N REGULATORY MATTERS**

The Corporation and the Bank are subject to various regulatory capital requirements administered by the federal banking regulators. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth below) of Tier 1 capital to average assets and of Tier 1 and total capital (as defined in the regulations) to risk weighted assets. Management believes, as of December 31, 2011, that the Corporation and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2011, the most recent notification from the federal banking regulators categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

Table of Contents**NOTE N REGULATORY MATTERS (Continued)**

On May 5, 2009, stockholders approved and ratified the ACNB Corporation 2009 Restricted Stock Plan, which awards shall not exceed, in the aggregate, 200,000 shares of Common Stock. As of December 31, 2011, no shares have been issued under the plan. In January 2011, the Corporation offered stockholders the opportunity to participate in the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan. The plan allows registered stockholders who have a minimal number of shares to participate and also provides for voluntary cash purchases of ACNB Corporation common stock. As of December 31, 2011, 17,466 shares of common stock were issued within the plan.

The actual and required capital amounts and ratios were as follows:

| Dollars in thousands                                      | Actual    |       | For Capital Adequacy Purposes |       | To be Well Capitalized under Prompt Corrective Action Provisions |       |
|---|-----------|-------|-------------------------------|-------|--|-------|
|   | Amount    | Ratio | Amount                        | Ratio | Amount   | Ratio |
| <b>CORPORATION</b>  |           |       |                               |       |  |       |
| <b>As of December 31, 2011</b>                            |           |       |                               |       |  |       |
| Tier 1 leverage ratio (to average assets)                 | \$ 87,546 | 8.71% | ≥40,215                       | ≥4.0% | N/A  | N/A   |
| Tier 1 risk-based capital ratio (to risk-weighted assets) | 87,546    | 12.75 | ≥27,464                       | ≥4.0  | N/A  | N/A   |
| Total risk-based capital ratio (to risk-weighted assets)  | 96,252    | 14.02 | ≥54,928                       | ≥8.0  | N/A  | N/A   |
| <b>As of December 31, 2010</b>                            |           |       |                               |       |  |       |
| Tier 1 leverage ratio (to average assets)                 | \$ 82,991 | 8.54% | ≥38,851                       | ≥4.0% | N/A  | N/A   |
| Tier 1 risk-based capital ratio (to risk-weighted assets) | 82,991    | 12.44 | ≥26,678                       | ≥4.0  | N/A  | N/A   |
| Total risk-based capital ratio (to risk-weighted assets)  | 91,450    | 13.71 | ≥53,356                       | ≥8.0  | N/A  | N/A   |
| <b>BANK</b>   |           |       |                               |       |  |       |
| <b>As of December 31, 2011</b>                            |           |       |                               |       |  |       |
| Tier 1 leverage ratio (to average assets)                 | \$ 82,703 | 8.24% | ≥40,144                       | ≥4.0% | ≥50,180  | ≥5.0% |
| Tier 1 risk-based capital ratio (to risk-weighted assets) | 82,703    | 12.07 | ≥27,415                       | ≥4.0  | ≥41,123  | ≥6.0  |
| Total risk-based capital ratio (to risk-weighted assets)  | 91,307    | 13.32 | ≥54,830                       | ≥8.0  | ≥68,538  | ≥10.0 |
| <b>As of December 31, 2010</b>                            |           |       |                               |       |  |       |
| Tier 1 leverage ratio (to average assets)                 | \$ 79,579 | 8.24% | ≥38,629                       | ≥4.0% | ≥48,286  | ≥5.0% |
| Tier 1 risk-based capital ratio (to risk-weighted assets) | 79,579    | 11.99 | ≥26,557                       | ≥4.0  | ≥39,835  | ≥6.0  |
| Total risk-based capital ratio (to risk-weighted assets)  | 87,965    | 13.25 | ≥53,114                       | ≥8.0  | ≥66,392  | ≥10.0 |

**NOTE O FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET 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 consist primarily of commitments to extend credit (typically mortgages and commercial loans) and, to a lesser

Table of Contents**NOTE O FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK (Continued)**

extent, standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

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 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 does not anticipate any material losses from these commitments.

Commitments to extend credit, including commitments to grant loans and unfunded commitments under lines of credit, are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. 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 extensions of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property and equipment and income-producing commercial properties. On loans secured by real estate, the Corporation generally requires loan to value ratios of no greater than 80%.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements and similar transactions. The terms of the letters of credit vary and may have renewal features. The credit risk involved in using letters of credit is essentially the same as that involved in extending loans to customers. The Corporation holds collateral supporting those commitments for which collateral is deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of December 31, 2011 and 2010, for guarantees under standby letters of credit issued is not material.

The Corporation has not been required to perform on any financial guarantees, and has not incurred any losses on its commitments, during the past two years.

A summary of the Corporation's commitments at December 31 were as follows:

| In thousands                 | 2011       | 2010       |
|------------------------------|------------|------------|
| Commitments to extend credit | \$ 129,586 | \$ 120,179 |
| Standby letters of credit    | 6,230      | 5,897      |

**NOTE P CONTINGENCIES**

The Corporation is subject to claims and lawsuits which arise primarily in the ordinary course of business. Based on information presently available and advice received from legal counsel representing the Corporation in connection with any such claims and lawsuits, it is the opinion of management that the disposition or ultimate determination of any such claims and lawsuits will not have a material adverse effect on the consolidated financial position, consolidated results of operations or liquidity of the Corporation.

Table of Contents**NOTE Q ACNB CORPORATION (PARENT COMPANY ONLY) FINANCIAL INFORMATION****STATEMENTS OF CONDITION**

| In thousands                                      | December 31,     |                  |
|---|------------------|------------------|
|   | 2011             | 2010             |
| <b>ASSETS</b>                                     |                  |                  |
| Cash  | \$ 266           | \$ 183           |
| Investment in banking subsidiary                  | 83,274           | 80,682           |
| Investment in other subsidiaries                  | 9,993            | 9,566            |
| Investments in low-income housing partnerships    | 3,774            | 4,124            |
| Securities and other assets                       | 1,634            | 1,324            |
| Receivable from banking subsidiary                | 724              | 374              |
| <b>Total Assets</b>                               | <b>\$ 99,665</b> | <b>\$ 96,253</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>       |                  |                  |
| Long-term debt                                    | \$ 2,191         | \$ 2,499         |
| Stockholders' equity                              | 97,474           | 93,754           |
| <b>Total Liabilities and Stockholders' Equity</b> | <b>\$ 99,665</b> | <b>\$ 96,253</b> |

**STATEMENTS OF INCOME**

| In thousands                                     | Years Ended December 31, |                 |                 |
|--|--------------------------|-----------------|-----------------|
|  | 2011                     | 2010            | 2009            |
| Dividends from banking subsidiary                | \$ 4,689                 | \$ 4,506        | \$ 4,512        |
| Other income                                     | 47                       | 288             | 293             |
|  | 4,736                    | 4,794           | 4,805           |
| Impairment charges on equity securities          |                          |                 | 522             |
| Expenses   | 494                      | 445             | 111             |
|  | 4,242                    | 4,349           | 4,172           |
| Income tax benefit                               | 709                      | 633             | 966             |
|  | 4,951                    | 4,982           | 5,138           |
| Equity in undistributed earnings of subsidiaries | 3,551                    | 3,437           | 2,081           |
| <b>Net Income</b>                                | <b>\$ 8,502</b>          | <b>\$ 8,419</b> | <b>\$ 7,219</b> |

Table of Contents**NOTE Q ACNB CORPORATION (PARENT COMPANY ONLY) FINANCIAL INFORMATION (Continued)****STATEMENTS OF CASH FLOWS**

| In thousands  | Years Ended December 31, |                |                |
|---|--------------------------|----------------|----------------|
|   | 2011                     | 2010           | 2009           |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                 |                          |                |                |
| Net income  | \$ 8,502                 | \$ 8,419       | \$ 7,219       |
| Equity in undistributed earnings of subsidiaries            | (3,551)                  | (3,437)        | (2,081)        |
| (Increase) Decrease in receivable from banking subsidiary   | (350)                    | 21             | 294            |
| Impairment charges on equity securities                     |                          |                | 522            |
| Other   | 45                       | 257            | 92             |
| <b>Net Cash Provided by Operating Activities</b>            | <b>4,646</b>             | <b>5,260</b>   | <b>6,046</b>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                 |                          |                |                |
| Investment in insurance agency subsidiary                   |                          |                |                |
| <b>Net Cash Used in Investing Activities</b>                |                          |                |                |
| <b>CASH FLOWS USED IN FINANCING ACTIVITIES</b>              |                          |                |                |
| Repayments on long-term debt                                | (308)                    | (795)          | (1,657)        |
| Purchase of treasury stock                                  |                          |                | (286)          |
| Proceeds from issuance of common stock                      | 257                      |                |                |
| Dividends paid  | (4,512)                  | (4,506)        | (4,512)        |
| <b>Net Cash Used in Financing Activities</b>                | <b>(4,563)</b>           | <b>(5,301)</b> | <b>(6,455)</b> |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b> | <b>83</b>                | <b>(41)</b>    | <b>(409)</b>   |
| <b>CASH AND CASH EQUIVALENTS BEGINNING</b>                  | <b>183</b>               | <b>224</b>     | <b>633</b>     |
| <b>CASH AND CASH EQUIVALENTS ENDING</b>                     | <b>\$ 266</b>            | <b>\$ 183</b>  | <b>\$ 224</b>  |

**NOTE R ACQUISITIONS**

In 2008, RIG acquired a book of business with an aggregate purchase price of \$1,165,000, of which, all was classified as an intangible asset. Also, on December 31, 2008, RIG acquired Marks Insurance & Associates, Inc. with an aggregate purchase price of \$1,853,000, of which \$1,300,000 was recorded as an intangible asset and \$553,000 was recorded as goodwill. The contingent consideration for both 2008 purchases was calculated based on 2011 results of operations. The contingent consideration of \$338,000 is included in goodwill and the other liabilities section of the consolidated statement of condition and was subsequently paid on January 13, 2012.

In 2010, RIG acquired an additional book of business with an aggregate purchase price of \$31,000, of which, all was classified as an intangible asset.

The carrying value and accumulated amortization of the intangible assets (customer lists) as of December 31, 2011 and 2010, are as follows:

| In thousands                | 2011                  |                          | 2010                  |                          |
|-----------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
|                             | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets | \$ 6,417              | \$ 3,368                 | \$ 6,415              | \$ 2,727                 |



Table of Contents**NOTE R ACQUISITIONS (Continued)**

Amortization of the intangible assets for the five years subsequent to December 31, 2011, is expected to be as follows:

| <b>Years Ending</b> | <b>In thousands</b> |
|---------------------|---------------------|
| 2012                | \$ 641              |
| 2013                | 641                 |
| 2014                | 641                 |
| 2015                | 316                 |
| 2016                | 314                 |

**NOTE S SEGMENT AND RELATED INFORMATION**

RIG is managed separately from the banking segment, which includes the Bank and related financial services that the Corporation offers. RIG offers a broad range of property and casualty, life and health insurance to both commercial and individual clients.

Segment information for 2011, 2010 and 2009 is as follows:

| <b>In thousands</b>  | <b>Banking</b> | <b>Insurance</b> | <b>Total</b> |
|--|----------------|------------------|--------------|
| <b>2011</b>  |                |                  |              |
| Net interest income and other income from external customers | \$ 41,463      | \$ 4,644         | \$ 46,107    |
| Income before income taxes                                   | 9,951          | 705              | 10,656       |
| Total assets   | 992,252        | 12,571           | 1,004,823    |
| Capital expenditures   | 1,938          | 4                | 1,942        |
| <b>2010</b>  |                |                  |              |
| Net interest income and other income from external customers | \$ 42,503      | \$ 4,686         | \$ 47,189    |
| Income before income taxes                                   | 10,005         | 471              | 10,476       |
| Total assets   | 956,662        | 12,005           | 968,667      |
| Capital expenditures   | 1,068          | 21               | 1,089        |
| <b>2009</b>  |                |                  |              |
| Net interest income and other income from external customers | \$ 38,607      | \$ 5,348         | \$ 43,955    |
| Income before income taxes                                   | 7,801          | 775              | 8,576        |
| Total assets   | 949,130        | 12,774           | 961,904      |
| Capital expenditures   | 1,902          | 49               | 1,951        |

Table of Contents**QUARTERLY RESULTS OF OPERATIONS**

Selected quarterly information for the years ended December 31, 2011 and 2010, is as follows:

| <b>In thousands, except per share data</b>          | <b>First<br/>Quarter</b> | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter</b> |
|---|--------------------------|---------------------------|--------------------------|---------------------------|
| <b>2011</b>   |                          |                           |                          |                           |
| Interest income                                     | \$ 10,480                | \$ 10,488                 | \$ 10,421                | \$ 10,443                 |
| Interest expense                                    | 1,916                    | 1,894                     | 1,863                    | 1,789                     |
| Net interest income                                 | 8,564                    | 8,594                     | 8,558                    | 8,654                     |
| Provision for loan losses                           | 1,100                    | 1,310                     | 1,200                    | 1,825                     |
| Net interest income after provision for loan losses | 7,464                    | 7,284                     | 7,358                    | 6,829                     |
| Net gains on sales of securities                    |                          |                           | 1                        |                           |
| Other income  | 2,957                    | 3,007                     | 2,881                    | 2,891                     |
| Other expenses and provision for income taxes       | 7,961                    | 8,185                     | 8,060                    | 7,964                     |
| Net income  | \$ 2,460                 | \$ 2,106                  | \$ 2,180                 | \$ 1,756                  |
| Basic earnings per share                            | \$ 0.41                  | \$ 0.36                   | \$ 0.37                  | \$ 0.29                   |
| Dividends per share                                 | \$ 0.19                  | \$ 0.19                   | \$ 0.19                  | \$ 0.19                   |
| <b>2010</b>   |                          |                           |                          |                           |
| Interest income                                     | \$ 11,125                | \$ 11,690                 | \$ 11,100                | \$ 10,725                 |
| Interest expense                                    | 2,555                    | 2,482                     | 2,388                    | 2,198                     |
| Net interest income                                 | 8,570                    | 9,208                     | 8,712                    | 8,527                     |
| Provision for loan losses                           | 859                      | 2,351                     | 1,400                    | 1,800                     |
| Net interest income after provision for loan losses | 7,711                    | 6,857                     | 7,312                    | 6,727                     |
| Net gains (losses) on sales of securities           | 26                       | (1)                       | 47                       |                           |
| Other income  | 2,842                    | 3,161                     | 2,869                    | 3,228                     |
| Other expenses and provision for income taxes       | 8,157                    | 7,952                     | 7,924                    | 8,327                     |
| Net income  | \$ 2,422                 | \$ 2,065                  | \$ 2,304                 | \$ 1,628                  |
| Basic earnings per share                            | \$ 0.41                  | \$ 0.35                   | \$ 0.39                  | \$ 0.27                   |
| Dividends per share                                 | \$ 0.19                  | \$ 0.19                   | \$ 0.19                  | \$ 0.19                   |

**ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A CONTROLS AND PROCEDURES****EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

The Corporation carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures are effective in timely alerting them to material information relating to the Corporation

(including its consolidated subsidiaries) required to be included in our periodic SEC filings.

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Based on our evaluation of the effectiveness of the design and operation of the disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures were effective as of December 31, 2011. The Corporation believes that the accompanying consolidated financial statements fairly present the financial condition and results of operations for the fiscal years presented in this report on Form 10-K.

**CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING**

We have made no changes in the Corporation's internal controls over financial reporting in connection with our fourth quarter evaluation that would materially affect, or are reasonably likely to materially affect, our internal controls over financial reporting

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**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

ACNB Corporation (ACNB) is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles, and as such, include some amounts that are based on management's best estimates and judgments.

ACNB's management is responsible for establishing and maintaining effective internal control over financial reporting. The system of internal control over financial reporting, as it relates to the consolidated financial statements, is evaluated for effectiveness by management and tested for reliability through a program of internal audits and management testing and review. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

The Board of Directors of ACNB, through its Audit Committee, meets regularly with management, internal auditors, and the independent registered public accounting firm. The Audit Committee provides oversight to ACNB by reviewing audit plans and results, and evaluates management's actions for internal control, accounting and financial reporting matters. The internal auditors and independent registered public accounting firm have direct and confidential access to the Audit Committee to discuss the results of their examinations.

Management assessed the effectiveness of ACNB's internal control over financial reporting as of December 31, 2011. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*. Based on our assessment, management concluded that as of December 31, 2011, ACNB's internal control over financial reporting is effective and meets the criteria of the *Internal Control Integrated Framework*.

ACNB's independent registered public accounting firm, ParenteBeard LLC, has issued an attestation report on ACNB's internal control over financial reporting. This report appears on pages 103 and 104.

/s/ THOMAS A. RITTER

/s/ DAVID W. CATHELL

\_\_\_\_\_  
Thomas A. Ritter  
President & Chief Executive Officer

\_\_\_\_\_  
David W. Cathell  
Executive Vice President, Treasurer &  
Chief Financial Officer

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and  
Stockholders of ACNB Corporation  
Gettysburg, Pennsylvania

We have audited ACNB Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). ACNB Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on ACNB Corporation and Subsidiaries' internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A corporation's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A corporation's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the corporation are being made only in accordance with authorizations of management and directors of the corporation; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the corporation's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, ACNB Corporation and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of condition and the related statements of income, changes in stockholders' equity, and cash flows of ACNB Corporation and Subsidiaries, and our report dated March 12, 2012 expressed an unqualified opinion.

ParenteBeard LLC  
Harrisburg, Pennsylvania  
March 12, 2012

**ITEM 9B OTHER INFORMATION**

None.

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**PART III**

**ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this Item 10, relating to directors, executive officers, and control persons, is set forth in sections "Information as to Nominees and Directors", "Executive Officers of ACNB Corporation", "Meetings and Committees of the Board of Directors", "Audit Committee Report" and "Section 16(a) Beneficial Ownership Reporting Compliance" of ACNB Corporation's definitive Proxy Statement to be used in connection with the 2012 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

The Corporation has adopted a Code of Ethics that applies to directors, officers and employees of the Corporation and its subsidiaries. A copy of the Code of Ethics is included as an exhibit to the Form 8-K filed by the Corporation on March 19, 2010. A request for the Corporation's Code of Ethics can be made either in writing to Lynda L. Glass, Executive Vice President, Secretary & Chief Governance Officer, ACNB Corporation, 16 Lincoln Square, P.O. Box 3129, Gettysburg, Pennsylvania 17325 or by telephone at 717-334-3161.

There have been no material changes to the procedures by which stockholders may recommend nominees to the Corporation's Board of Directors.

**ITEM 11 EXECUTIVE COMPENSATION**

Incorporated by reference in response to this Item 11 is the information appearing under the headings "Compensation and Plan Information", "Potential Payments Upon Termination or Change In Control", "Compensation Committee Report" and "Compensation Committee Interlocks and Insider Participation" in ACNB Corporation's 2012 definitive Proxy Statement.

**ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Incorporated by reference in response to this Item 12 is the information appearing under the heading "Share Ownership" in ACNB Corporation's 2012 definitive Proxy Statement.

**ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

Incorporated by reference in response to this Item 13 is the information appearing under the headings "Transactions with Directors and Executive Officers" and "Governance of the Corporation" in ACNB Corporation's 2012 definitive Proxy Statement.

**ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Incorporated by reference in response to this Item 14 is the information appearing under the heading "Independent Auditors" in ACNB Corporation's 2012 definitive Proxy Statement.

**PART IV**

**ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a)

**1. FINANCIAL STATEMENTS**

The following financial statements are filed as part of this report:

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Condition





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Consolidated Statements of Income

Consolidated Statements of Changes in Stockholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

2.

**FINANCIAL STATEMENT SCHEDULES**

Financial statement schedules are omitted because the required information is either not applicable, not required, or is shown in the respective consolidated financial statements or in the notes thereto.

(b)

**EXHIBITS**

The following exhibits are included in this report:

- Exhibit 3(i) Articles of Incorporation of ACNB Corporation, as amended. (Incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K, filed with the Commission on June 2, 2009.)
- Exhibit 3(ii) Bylaws of ACNB Corporation, as amended. (Incorporated by reference to Exhibit 3.2 of the Registrant's Current Report on Form 8-K, filed with the Commission on March 22, 2010.)
- Exhibit 10.1 ACNB Corporation, ACNB Acquisition Subsidiary LLC, and Russell Insurance Group, Inc. Stock Purchase Agreement. (Incorporated by reference to Exhibit 10.2 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
- Exhibit 10.2 Salary Continuation Agreement Applicable to Ronald L. Hankey, Thomas A. Ritter and Lynda L. Glass. (Incorporated by reference to Exhibit 10.2 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
- Exhibit 10.3 Executive Supplemental Life Insurance Plan Applicable to Ronald L. Hankey, Thomas A. Ritter, David W. Cathell and Lynda L. Glass. (Incorporated by reference to Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the Commission on November 7, 2008.)
- Exhibit 10.4 Director Supplemental Life Insurance Plan Applicable to Frank Elsner III, James J. Lott, Robert W. Miller, Daniel W. Potts, Marian B. Schultz, David L. Sites, Alan J. Stock, Jennifer L. Weaver, Harry L. Wheeler and James E. Williams. (Incorporated by reference to Exhibit 10.5 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
- Exhibit 10.5 Amended and Restated Director Deferred Fee Plan Applicable to Frank Elsner III, James J. Lott, Robert W. Miller, Marian B. Schultz, Alan J. Stock, Jennifer L. Weaver, Harry L. Wheeler and James E. Williams. (Incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K, filed with the Commission on January 6, 2012.)
- Exhibit 10.6 ACNB Bank Salary Savings Plan. (Incorporated by reference to Exhibit 10.6 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Commission on March 12, 2010.)

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- Exhibit 10.7 Group Pension Plan for Employees of ACNB Bank. (Incorporated by reference to Exhibit 10.7 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Commission on March 12, 2010.)
- Exhibit 10.8 Complete Settlement Agreement and General Release made among ACNB Corporation, Adams County National Bank and John W. Krichten effective June 13, 2006. (Incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K, filed with the Commission on June 15, 2006.)
- Exhibit 10.9 Employment Agreement between ACNB Corporation, Adams County National Bank and Thomas A. Ritter dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.9 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
- Exhibit 10.10 Employment Agreement between ACNB Corporation, Adams County National Bank and Lynda L. Glass dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.10 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
- Exhibit 10.11 Employment Agreement between ACNB Corporation, Russell Insurance Group, Inc. and Frank C. Russell, Jr. dated as of January 13, 2011. (Incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K, filed with the Commission on January 19, 2011.)
- Exhibit 10.12 Employment Agreement between ACNB Corporation, Adams County National Bank and David W. Cathell dated as of April 17, 2009. (Incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K, filed with the Commission on April 23, 2009.)
- Exhibit 10.13 2009 Restricted Stock Plan. (Incorporated by reference to Appendix C of the Registrant's Proxy Statement on Schedule 14A, filed with the Commission on March 25, 2009.)
- Exhibit 11 Statement re Computation of Earnings. (Incorporated by reference to page 69 of this Form 10-K.)
- Exhibit 14 Code of Ethics. (Incorporated by reference to Exhibit 14 of the Registrant's Current Report on Form 8-K, filed with the Commission on March 19, 2010.)
- Exhibit 21 Subsidiaries of the Registrant.
- Exhibit 23 Consent of Independent Registered Public Accounting Firm
- Exhibit 31.1 Chief Executive Officer Certification of Annual Report on Form 10-K.
- Exhibit 31.2 Chief Financial Officer Certification of Annual Report on Form 10-K.
- Exhibit 32.1 Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32.2 Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase.
- Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase.
- Exhibit 101.INS XBRL Instance Document.
- Exhibit 101.SCH XBRL Taxonomy Extension Schema.
- Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase.

Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACNB CORPORATION (Registrant)

March 12, 2012

\_\_\_\_\_  
Date

By: /s/ THOMAS A. RITTER

\_\_\_\_\_  
Thomas A. Ritter  
President & Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed on March 12, 2012, by the following persons in the capacities indicated.

/s/ DAVID W. CATHELL

\_\_\_\_\_  
David W. Cathell  
Executive Vice President,  
Treasurer & Chief Financial Officer  
(Principal Financial Officer)

/s/ THOMAS A. RITTER

\_\_\_\_\_  
Thomas A. Ritter  
Director and President & Chief Executive Officer

/s/ FRANK ELSNER, III

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Frank Elsner, III  
Director and Vice Chairman of the Board

/s/ MARIAN B. SCHULTZ

\_\_\_\_\_  
Marian B. Schultz  
Director

/s/ RONALD L. HANKEY

\_\_\_\_\_  
Ronald L. Hankey  
Director and Chairman of the Board

/s/ DAVID L. SITES

\_\_\_\_\_  
David L. Sites  
Director

/s/ JAMES J. LOTT

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James J. Lott  
Director

/s/ ALAN J. STOCK

\_\_\_\_\_  
Alan J. Stock  
Director

/s/ ROBERT W. MILLER

\_\_\_\_\_  
Robert W. Miller  
Director

\_\_\_\_\_  
Jennifer L. Weaver  
Director

/s/ DANIEL W. POTTS

\_\_\_\_\_  
Daniel W. Potts  
Director

/s/ HARRY L. WHEELER

\_\_\_\_\_  
Harry L. Wheeler  
Director

/s/ JAMES E. WILLIAMS

\_\_\_\_\_  
James E. Williams  
Director

