ACNB CORP
Form 10-Q
August 03, 2012

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, DC 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended June 30, 2012**

**Commission file number 0-11783**

# ACNB CORPORATION

(Exact name of Registrant as specified in its charter)

| **Pennsylvania** | **23-2233457** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **16 Lincoln Square, Gettysburg, Pennsylvania** | **17325** |
| (Address of principal executive offices) | (Zip Code) |

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, $2.50 par value per share | The NASDAQ Stock Market, LLC |

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

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 x No o

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer x |
| Non-accelerated filer o | Smaller reporting company o |

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

The number of shares of the Registrant s Common Stock outstanding on July 27, 2012, was 5,955,535.

**PART I - FINANCIAL INFORMATION**

**ACNB CORPORATION**

**ITEM 1 - FINANCIAL STATEMENTS**

**CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)**

| Dollars in thousands, except per share data | June 30, 2012 | June 30, 2011 | December 31, 2011 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and due from banks | **$ 13,620** | $ 13,382 | $ 14,423 |
| Interest bearing deposits with banks | **53,605** | 28,510 | 8,200 |
| Total Cash and Cash Equivalents | **67,225** | 41,892 | 22,623 |
| Securities available for sale | **188,711** | 207,719 | 209,227 |
| Securities held to maturity, fair value $29,011; $10,702; $10,680 | **28,388** | 10,038 | 10,032 |
| Loans held for sale | **1,540** | 825 | 337 |
| Loans, net of allowance for loan losses $15,322; $14,700; $15,482 | **676,984** | 653,652 | 678,986 |
| Premises and equipment | **14,723** | 14,418 | 14,483 |
| Restricted investment in bank stocks | **6,478** | 7,886 | 7,146 |
| Investment in bank-owned life insurance | **30,832** | 27,931 | 28,411 |
| Investments in low-income housing partnerships | **3,566** | 3,946 | 3,774 |
| Goodwill | **6,308** | 5,972 | 6,308 |
| Intangible assets | **2,730** | 3,369 | 3,049 |
| Foreclosed assets held for resale | **5,247** | 3,631 | 4,437 |
| Other assets | **14,587** | 17,058 | 16,010 |
| **Total Assets** | **$ 1,047,319** | $ 998,337 | $ 1,004,823 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | |
| **LIABILITIES** | | | |
| Deposits: | | | |
| Non-interest bearing | **$ 115,616** | $ 112,411 | $ 112,247 |
| Interest bearing | **702,346** | 656,989 | 670,548 |
| Total Deposits | **817,962** | 769,400 | 782,795 |
| Short-term borrowings | **42,601** | 47,924 | 45,962 |
| Long-term borrowings | **80,074** | 76,305 | 71,191 |
| Other liabilities | **6,772** | 7,375 | 7,401 |
| **Total Liabilities** | **947,409** | 901,004 | 907,349 |
| **STOCKHOLDERS EQUITY** | | | |
| Common stock, $2.50 par value; 20,000,000 shares authorized; 6,018,135, 5,999,840 and 6,008,409 shares issued; 5,955,535, 5,937,240 and 5,945,809 shares outstanding | **15,045** | 14,999 | 15,021 |

| | | | |
|---|---|---|---|
| Treasury stock, at cost (62,600 shares) | **(728)** | (728) | (728) |
| Additional paid-in capital | **9,117** | 8,901 | 9,000 |
| Retained earnings | **75,630** | 71,848 | 73,526 |
| Accumulated other comprehensive income | **846** | 2,313 | 655 |
| **Total Stockholders Equity** | **99,910** | 97,333 | 97,474 |
| **Total Liabilities and Stockholders Equity** | **$ 1,047,319** | $ 998,337 | $ 1,004,823 |

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

**ACNB CORPORATION**

**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

| Dollars in thousands, except per share data | Three Months Ended June 30, 2012 | 2011 | Six Months Ended June 30, 2012 | 2011 |
|---|---|---|---|---|
| **INTEREST INCOME** | | | | |
| Loans, including fees | | | | |
| Securities: | **$ 8,504** | $ 8,605 | **$ 17,067** | $ 17,228 |
| Taxable | **1,265** | 1,550 | **2,600** | 3,081 |
| Tax-exempt | **371** | 304 | **737** | 608 |
| Dividends | **4** | 3 | **7** | 6 |
| Other | **19** | 26 | **23** | 45 |
| **Total Interest Income** | **10,163** | 10,488 | **20,434** | 20,968 |
| **INTEREST EXPENSE** | | | | |
| Deposits | **872** | 1,111 | **1,788** | 2,247 |
| Short-term borrowings | **21** | 28 | **41** | 48 |
| Long-term borrowings | **702** | 755 | **1,397** | 1,515 |
| **Total Interest Expense** | **1,595** | 1,894 | **3,226** | 3,810 |
| **Net Interest Income** | **8,568** | 8,594 | **17,208** | 17,158 |
| **PROVISION FOR LOAN LOSSES** | **1,125** | 1,310 | **2,250** | 2,410 |
| **Net Interest Income after Provision for Loan Losses** | **7,443** | 7,284 | **14,958** | 14,748 |
| **OTHER INCOME** | | | | |
| Service charges on deposit accounts | **603** | 603 | **1,155** | 1,166 |
| Income from fiduciary activities | **356** | 329 | **644** | 702 |
| Earnings on investment in bank-owned life insurance | **242** | 251 | **480** | 488 |
| Net gains on sales or calls of securities | **3** | | **7** | |
| Service charges on ATM and debit card transactions | **323** | 320 | **632** | 598 |
| Commissions from insurance sales | **1,295** | 1,308 | **2,500** | 2,513 |
| Other | **243** | 196 | **463** | 497 |
| **Total Other Income** | **3,065** | 3,007 | **5,881** | 5,964 |
| **OTHER EXPENSES** | | | | |
| Salaries and employee benefits | **4,672** | 4,335 | **9,245** | 8,465 |
| Net occupancy | **497** | 500 | **990** | 1,056 |
| Equipment | **671** | 682 | **1,282** | 1,344 |
| Other tax | **170** | 175 | **393** | 383 |
| Professional services | **251** | 261 | **442** | 470 |
| Supplies and postage | **152** | 166 | **327** | 320 |
| Marketing and corporate relations | **90** | 128 | **190** | 252 |
| FDIC and regulatory | **218** | 335 | **451** | 740 |
| Intangible assets amortization | **161** | 160 | **321** | 321 |
| Foreclosed real estate expenses | **165** | 143 | **230** | 10 |
| Other operating | **793** | 768 | **1,508** | 1,511 |
| **Total Other Expenses** | **7,840** | 7,653 | **15,379** | 14,872 |
| **Income before Income Taxes** | **2,668** | 2,638 | **5,460** | 5,840 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **PROVISION FOR INCOME TAXES** | | **540** | | 532 | | **1,096** | 1,274 |
| | | | | | | | |
| **Net Income** | **$** | **2,128** | $ | 2,106 | **$** | **4,364** | $ 4,566 |
| **PER SHARE DATA** | | | | | | | |
| Basic earnings | **$** | **0.35** | $ | 0.36 | **$** | **0.73** | $ 0.77 |
| Cash dividends declared | **$** | **0.19** | $ | 0.19 | **$** | **0.38** | $ 0.38 |

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

**ACNB CORPORATION**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**

| Dollars in thousands | Three Months Ended June 30, 2012 | 2011 | Six Months Ended June 30, 2012 | 2011 |
|---|---|---|---|---|
| **NET INCOME** | **$ 2,128** | $ 2,106 | **$ 4,364** | $ 4,566 |
| **OTHER COMPREHENSIVE INCOME (LOSS)** | | | | |
| **SECURITIES** | | | | |
| Unrealized gains (losses) arising during the period, net of income taxes of $81, $637, $(10) and $551, respectively | **156** | 1,237 | **(21)** | 1,069 |
| Reclassification adjustment for net gains included in net income, net of income taxes of $(1), $0, $(2) and $0, respectively | **(2)** | | **(5)** | |
| **PENSION** | | | | |
| Change in plan assets and benefit obligations, net of income taxes of $56, $17, $113 and $34, respectively | **109** | 31 | **217** | 62 |
| **TOTAL OTHER COMPREHENSIVE INCOME** | **263** | 1,268 | **191** | 1,131 |
| **TOTAL COMPREHENSIVE INCOME** | **$ 2,391** | $ 3,374 | **$ 4,555** | $ 5,697 |

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

**ACNB CORPORATION**

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)**

**Six Months Ended June 30, 2012 and 2011**

| Dollars in thousands | Common Stock | Treasury Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Total Stockholders Equity |
|---|---|---|---|---|---|---|
| **BALANCE JANUARY 1, 2011** | $ 14,977 | $ (728) | $ 8,787 | $ 69,536 | $ 1,182 | $ 93,754 |
| Comprehensive income: | | | | | | |
| Net income | | | | 4,566 | | 4,566 |
| Other comprehensive income, net of taxes | | | | | 1,131 | 1,131 |
| **Total Comprehensive Income** | | | | | | 5,697 |
| Common stock shares issued (8,897 shares) | 22 | | 114 | | | 136 |
| Cash dividends declared | | | | (2,254) | | (2,254) |
| **BALANCE JUNE 30, 2011** | $ 14,999 | $ (728) | $ 8,901 | $ 71,848 | $ 2,313 | $ 97,333 |
| **BALANCE JANUARY 1, 2012** | **$ 15,021** | **$ (728)** | **$ 9,000** | **$ 73,526** | **$ 655** | **$ 97,474** |
| Comprehensive income: | | | | | | |
| Net income | | | | **4,364** | | **4,364** |
| Other comprehensive income, net of taxes | | | | | **191** | **191** |
| **Total Comprehensive Income** | | | | | | **4,555** |
| Common stock shares issued (9,726 shares) | **24** | | **117** | | | **141** |
| Cash dividends declared | | | | **(2,260)** | | **(2,260)** |
| **BALANCE JUNE 30, 2012** | **$ 15,045** | **$ (728)** | **$ 9,117** | **$ 75,630** | **$ 846** | **$ 99,910** |

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

**ACNB CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

| Dollars in thousands | Six Months Ended June 30, 2012 | 2011 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income | **$ 4,364** | $ 4,566 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Gain on sales of loans and foreclosed real estate, net of write-downs on foreclosed real estate | **(32)** | (284) |
| Earnings on investment in bank-owned life insurance | **(480)** | (488) |
| Gain on sales or calls of securities | **(7)** | |
| Depreciation and amortization | **1,023** | 1,135 |
| Provision for loan losses | **2,250** | 2,410 |
| Net amortization of investment securities premiums | **426** | 248 |
| Decrease (increase) in interest receivable | **228** | (125) |
| Increase (decrease) in interest payable | **(224)** | 53 |
| Mortgage loans originated for sale | **(8,940)** | (10,770) |
| Proceeds from loans sold to others | **7,827** | 13,212 |
| Decrease in other assets | **1,303** | 1,646 |
| Decrease in other liabilities | **(75)** | (384) |
| **Net Cash Provided by Operating Activities** | **7,663** | 11,219 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Proceeds from maturities of investment securities held to maturity | **1,056** | |
| Proceeds from maturities of investment securities available for sale | **38,417** | 24,291 |
| Purchase of investment securities held to maturity | **(19,429)** | |
| Purchase of investment securities available for sale | **(18,342)** | (39,902) |
| Net increase in loans | **(2,060)** | (7,490) |
| Redemption of restricted investment in bank stocks | **668** | 534 |
| Purchase of bank-owned life insurance | **(1,941)** | |
| Capital expenditures | **(944)** | (1,113) |
| Proceeds from sale of foreclosed real estate | **944** | 5,780 |
| **Net Cash Used in Investing Activities** | **(1,631)** | (17,900) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Net increase in demand deposits | **3,369** | 8,947 |
| Net increase in time certificates of deposits and interest bearing deposits | **31,798** | 13,927 |
| Net increase (decrease) in short-term borrowings | **(3,361)** | 8,838 |
| Dividends paid | **(2,260)** | (2,254) |
| Common stock issued | **141** | 136 |
| Proceeds from long-term borrowings | **10,000** | |
| Repayments on long-term borrowings | **(1,117)** | (5,194) |
| **Net Cash Provided by Financing Activities** | **38,570** | 24,400 |
| **Net Increase in Cash and Cash Equivalents** | **44,602** | 17,719 |
| **CASH AND CASH EQUIVALENTS BEGINNING** | **22,623** | 24,173 |
| **CASH AND CASH EQUIVALENTS ENDING** | **$ 67,225** | $ 41,892 |

| | | | | |
|---|---|---|---|---|
| Interest paid | **$** | **3,450** | $ | 3,757 |
| Incomes taxes paid | **$** | | **$** | 900 |
| Loans transferred to foreclosed assets held for resale | **$** | **1,812** | $ | 1,467 |

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

**ACNB CORPORATION**

**ITEM 1 - NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. **Basis of Presentation**

ACNB Corporation, headquartered in Gettysburg, Pennsylvania, provides banking, insurance, and financial services to businesses and consumers through its wholly-owned subsidiaries, ACNB 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 office 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, disability and accident insurance are funded. Each entity is responsible for the activity in its respective cell. The financial activity for the insurance cell has been reported 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.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to present fairly ACNB Corporation s financial position and results of operations, comprehensive income, changes in stockholders equity, and cash flows. All such adjustments are of a normal recurring nature.

The accounting policies followed by the Corporation are set forth in Note A to the Corporation s consolidated financial statements in the 2011 ACNB Corporation Annual Report on Form 10-K, filed with the SEC on March 12, 2012. It is suggested that the consolidated financial statements contained herein be read in conjunction with the consolidated financial statements and notes included in the Corporation s Annual Report on Form 10-K. The results of operations for the three and six month periods ended June 30, 2012, are not necessarily indicative of the results to be expected for the full year.

The Corporation has evaluated events and transactions occurring subsequent to the statement of condition date of June 30, 2012, 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.

2. **Earnings Per Share**

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 5,948,433 and 5,931,962 weighted average shares of common stock outstanding for the six months ended June 30, 2012 and 2011, respectively, and 5,950,424 and 5,934,543 for the three months ended June 30, 2012 and 2011, respectively. The Corporation does not have dilutive securities outstanding.

3. **Retirement Benefits**

The components of net periodic benefit cost (income) related to the non-contributory, defined benefit pension plan for the three month and six month periods ended June 30 were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| **In thousands** | **2012** | **2011** | **2012** | **2011** |
| Service cost | **$ 163** | $ 143 | **$ 326** | $ 286 |
| Interest cost | **231** | 240 | **462** | 480 |
| Expected return on plan assets | **(443)** | (457) | **(886)** | (914) |
| Amortization of net loss | **153** | 35 | **306** | 70 |
| Amortization of transition obligation | **2** | 3 | **4** | 6 |
| Amortization of prior service cost | **10** | 10 | **20** | 20 |
| | | | | |
| **Net Periodic Benefit Cost (Income)** | **$ 116** | $ (26) | **$ 232** | (52) |

The Corporation previously disclosed in its consolidated financial statements for the year ended December 31, 2011, that it had not yet determined the amount the Bank plans on contributing to the plan in 2012. As of June 30, 2012, this contribution amount has still not been determined. Effective April 1, 2012, no inactive or former participant in the plan will be eligible to again participate in the plan, and no employee hired after March 31, 2012, will be eligible to participate in the plan.

4. **Guarantees**

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $5,800,000 in standby letters of credit as of June 30, 2012. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability, as of June 30, 2012, for guarantees under standby letters of credit issued is not material.

5. **Accumulated Other Comprehensive Income**

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

| In thousands | | Unrealized Gains on Securities | Pension Liability | Accumulated Other Comprehensive Income |
|---|---|---|---|---|
| **BALANCE** | **JUNE 30, 2012** | **$ 5,970** | **$ (5,124)** | **$ 846** |
| BALANCE | DECEMBER 31, 2011 | $ 5,996 | $ (5,341) | $ 655 |
| BALANCE | JUNE 30, 2011 | $ 4,992 | $ (2,679) | $ 2,313 |

6. **Segment Reporting**

Russell Insurance Group, Inc. (RIG) is managed separately from the banking segment, which includes the Bank and related financial services that the Corporation offers through its banking subsidiary. RIG offers a broad range of property and casualty, life and health insurance to both commercial and individual clients.

Segment information for the six month periods ended June 30, 2012 and 2011, is as follows:

| In thousands | Banking | Insurance | Intercompany Eliminations | Total |
|---|---|---|---|---|
| **2012** | | | | |
| Net interest income and other income from external customers | **$ 20,605** | **$ 2,484** | **$** | **$ 23,089** |
| Income before income taxes | **5,049** | **411** | | **5,460** |
| Total assets | **1,036,693** | **12,186** | **(1,560)** | **1,047,319** |
| Capital expenditures | **872** | **72** | | **944** |
| | | | | |
| **2011** | | | | |
| Net interest income and other income from external customers | $ 20,619 | $ 2,503 | $ | $ 23,122 |
| Income before income taxes | 5,309 | 531 | | 5,840 |
| Total assets | 988,022 | 11,850 | (1,535) | 998,337 |
| Capital expenditures | 1,111 | 2 | | 1,113 |

Segment information for the three month periods ended June 30, 2012 and 2011, is as follows:

| In thousands | Banking | Insurance | Intercompany Eliminations | Total |
|---|---|---|---|---|
| **2012** | | | | |
| Net interest income and other income from external customers | **$ 10,342** | **$ 1,291** | **$** | **$ 11,633** |
| Income before income taxes | **2,447** | **221** | | **2,668** |
| Total assets | **1,036,693** | **12,186** | **(1,560)** | **1,047,319** |
| Capital expenditures | **370** | | | **370** |
| | | | | |
| **2011** | | | | |
| Net interest income and other income from external customers | $ 10,299 | $ 1,302 | $ | $ 11,601 |
| Income before income taxes | 2,376 | 262 | | 2,638 |
| Total assets | 988,022 | 11,850 | (1,535) | 998,337 |
| Capital expenditures | 875 | | | 875 |

Intangible assets, representing customer lists, are amortized over 10 years on a straight line basis. Goodwill is not amortized, but rather is analyzed annually for impairment. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested for impairment when such events occur. Amortization of goodwill and the intangible assets is deductible for tax purposes.

During the quarter ended June 30, 2012, the Corporation changed its method of applying ASC 350 such that the annual goodwill impairment testing date will be changed from December 31st to October 1st. This new testing date is preferable in the circumstances, because it will allow the Corporation more time to accurately complete its impairment testing process in order to incorporate the results in its annual consolidated financial statements and timely file those statements with the Securities and Exchange Commission in accordance with its accelerated filing requirements.

7. **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 security, 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.

Amortized cost and fair value at June 30, 2012, and December 31, 2011, were as follows:

| In thousands | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **SECURITIES AVAILABLE FOR SALE** | | | | |
| **JUNE 30, 2012** | | | | |
| U.S. Government and agencies | **$ 28,292** | **$ 1,041** | **$** | **$ 29,333** |
| Mortgage-backed securities | **93,075** | **5,237** | | **98,312** |
| State and municipal | **49,613** | **2,301** | **17** | **51,897** |
| Corporate bonds | **7,016** | **294** | **17** | **7,293** |
| CRA mutual fund | **1,044** | **51** | | **1,095** |
| Stock in other banks | **627** | **154** | | **781** |
| | **$ 179,667** | **$ 9,078** | **$ 34** | **$ 188,711** |
| **DECEMBER 31, 2011** | | | | |
| 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 |
| **SECURITIES HELD TO MATURITY** | | | | |
| **JUNE 30, 2012** | **$ 16,046** | **$ 605** | **$** | **$ 16,651** |
| U.S. Government and agencies | **12,342** | **18** | | **12,360** |
| Mortgage-backed securities | **$ 28,388** | **$ 623** | **$** | **29,011** |

| | | | | |
|---|---|---|---|---|
| **DECEMBER 31, 2011** | | | | |
| U.S. Government and agencies | $ 10,032 | $ 648 | $ | $ 10,680 |

The following table shows the Corporation s gross unrealized losses and fair value for investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2012, and December 31, 2011:

| In thousands | Less than 12 Months Fair Value | Less than 12 Months Unrealized Losses | 12 Months or More Fair Value | 12 Months or More Unrealized Losses | Total Fair Value | Total Unrealized Losses |
|---|---|---|---|---|---|---|
| **SECURITIES AVAILABLE FOR SALE** | | | | | | |
| **JUNE 30, 2012** | | | | | | |
| State and municipal | **$ 2,492** | **$ 17** | **$** | **$** | **$ 2,492** | **$ 17** |
| Corporate bonds | | | **983** | **17** | **983** | **17** |
| | **$ 2,492** | **$ 17** | **$ 983** | **$ 17** | **$ 3,475** | **$ 34** |
| **DECEMBER 31, 2011** | | | | | | |
| 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 |

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 June 30, 2012, five state and municipal bonds had unrealized losses that individually did not exceed 2% of amortized cost. These securities have not 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 the specific securities.

At June 30, 2012, one corporate bond had an unrealized loss. This security has been in a continuous loss position for 12 months or more. This security had an unrealized loss of less than 2% of amortized cost. This unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the specific security.

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.

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 security 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 June 30, 2012, management had not identified any securities with an unrealized loss that it intends or will be required to sell.

Amortized cost and fair value at June 30, 2012, by contractual maturity, where applicable, 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 Amortized Cost | Available for Sale Fair Value | Held to Maturity Amortized Cost | Held to Maturity Fair Value |
|---|---|---|---|---|
| 1 year or less | $ 1,507 | $ 1,522 | $ | $ |
| Over 1 year through 5 years | 33,702 | 35,321 | 10,025 | 10,582 |
| Over 5 years through 10 years | 41,373 | 42,953 | 6,021 | 6,069 |
| Over 10 years | 8,339 | 8,727 | | |
| Mortgage-backed securities | 93,075 | 98,312 | 12,342 | 12,360 |
| CRA mutual fund | 1,044 | 1,095 | | |
| Stock in other banks | 627 | 781 | | |
| | $ 179,667 | $ 188,711 | $ 28,388 | $ 29,011 |

The Corporation realized gross gains of $3,000 during the second quarter of 2012 and $0 during the second quarter of 2011, as well as $0 gross losses during the second quarters of 2012 and 2011, on sales or calls of securities available for sale. For the six month period ended June 30, 2012, the Corporation realized gross gains of $7,000 and $0 in gross losses on sales or calls of securities available for sale. For the six month period ended June 30, 2011, the Corporation did not realize any gross gains or losses on sales of securities available for sale.

At June 30, 2012, and December 31, 2011, securities with a carrying value of $124,489,000 and $124,069,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements, and for other purposes.

8. **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 payoff 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.

The accrual of interest on 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. Residential mortgages and home equity lines of credit that are secured by residential mortgages are charged off at the value of the property less costs to sell when the loan becomes 180 days past due. Consumer loans are typically charged off no later than 120 days past due. Past due status is based on the 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 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 reserve for unfunded lending commitments is not material to the consolidated financial 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 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, the 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 component relates 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 on the average loss ratio for the previous twelve quarters for each specific loan pool, adjusted for qualitative risk 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;

- 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 the Corporation s impaired loans are measured based on the estimated fair value of the loan s collateral or the discounted cash flows method.

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.

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 by using documents such as invoices, inventory reports, accounts receivable aging reports, or collateral appraisals.

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.

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 real estate 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, and other factors.

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, and the reliability and predictability of the projected cash flow generated by the project using feasibility studies, market data, and other pertinent information.

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, including home equity closed-end loans, 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 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 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 weakened housing market.

**Consumer Lending** - The Corporation offers a variety of unsecured and secured consumer loans, including those for vehicles and mobile homes and those 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 is 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.

The following table presents 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 June 30, 2012, and December 31, 2011:

| In thousands | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| **JUNE 30, 2012** | | | | | |
| Commercial and industrial | **$ 46,040** | **$ 3,984** | **$ 986** | **$** | **$ 51,010** |
| Commercial real estate | **200,171** | **17,532** | **17,271** | | **234,974** |
| Commercial real estate construction | **7,779** | **9,529** | **1,747** | | **19,055** |
| Residential mortgage | **312,312** | **4,142** | **2,941** | | **319,395** |
| Home equity lines of credit | **50,043** | **1,869** | **261** | | **52,173** |
| Consumer | **15,699** | | | | **15,699** |
| | **$ 632,044** | **$ 37,056** | **$ 23,206** | **$** | **$ 692,306** |
| **DECEMBER 31, 2011** | | | | | |
| 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 |
| | $ 626,979 | $ 43,836 | $ 23,653 | $ | $ 694,468 |

The following table summarizes information relative to impaired loans by loan portfolio class as of June 30, 2012, and December 31, 2011:

| | Impaired Loans with Allowance | | | Impaired Loans with No Allowance | |
|---|---|---|---|---|---|
| In thousands | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance |
| **JUNE 30, 2012** | | | | | |
| Commercial and industrial | **$** | **$** | **$** | **$ 222** | **$ 1,337** |
| Commercial real estate | **1,330** | **1,330** | **274** | **8,634** | **8,873** |
| Commercial real estate construction | | | | **922** | **1,196** |
| Residential mortgage | | | | **1,498** | **1,847** |
| | **$ 1,330** | **$ 1,330** | **$ 274** | **$ 11,276** | **$ 13,253** |
| | | | | | |
| **DECEMBER 31, 2011** | | | | | |
| 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 |

The following table summarizes information in regards to the average balance of impaired loans and related interest income by loan portfolio class for the three months ended June 30, 2012 and 2011:

| In thousands | Impaired Loans with Allowance: Average Recorded Investment | Impaired Loans with Allowance: Interest Income | Impaired Loans with No Allowance: Average Recorded Investment | Impaired Loans with No Allowance: Interest Income |
|---|---|---|---|---|
| **JUNE 30, 2012** | | | | |
| Commercial and industrial | **$ 22** | **$** | **$ 229** | **$** |
| Commercial real estate | **1,046** | | **8,568** | |
| Commercial real estate construction | **839** | | **933** | |
| Residential mortgage | | | **1,605** | |
| | **$ 1,907** | **$** | **$ 11,335** | **$** |
| | | | | |
| **JUNE 30, 2011** | | | | |
| Commercial and industrial | $ 361 | $ | $ | $ |
| Commercial real estate | 3,634 | | 3,548 | |
| Commercial real estate construction | 3,706 | | | |
| Residential mortgage | 899 | | 492 | |
| | $ 8,600 | $ | $ 4,040 | $ |

The following table summarizes information in regards to average of impaired loans and related interest income by loan portfolio class for the six months ended June 30, 2012 and 2011:

| In thousands | Impaired Loans with Allowance: Average Recorded Investment | Impaired Loans with Allowance: Interest Income | Impaired Loans with No Allowance: Average Recorded Investment | Impaired Loans with No Allowance: Interest Income |
|---|---|---|---|---|
| **JUNE 30, 2012** | | | | |
| Commercial and industrial | **$ 671** | **$** | **$ 236** | **$** |
| Commercial real estate | **788** | | **7,825** | |
| Commercial real estate construction | **560** | | **1,493** | |
| Residential mortgage | **29** | | **1,508** | |
| | **$ 2,048** | **$** | **$ 11,062** | **$** |
| | | | | |
| **JUNE 30, 2011** | | | | |
| Commercial and industrial | $ 410 | $ | $ | $ |
| Commercial real estate | 3,971 | | 3,735 | 44 |
| Commercial real estate construction | 3,933 | | | |
| Residential mortgage | 931 | | 346 | |
| | $ 9,245 | $ | $ 4,081 | $ 44 |

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

The following table presents nonaccrual loans by loan portfolio class as of June 30, 2012, and December 31, 2011:

| In thousands | June 30, 2012 | December 31, 2011 |
|---|---|---|
| Commercial and industrial | **$ 222** | $ 2,219 |
| Commercial real estate | **5,415** | 6,612 |
| Commercial real estate construction | **922** | 2,614 |
| Residential mortgage | **1,171** | 1,401 |
| | **$ 7,730** | $ 12,846 |

The following table summarizes information relative to troubled debt restructurings by loan portfolio class as of June 30, 2012, and December 31, 2011:

| In thousands | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Recorded Investment |
|---|---|---|---|
| **JUNE 30, 2012** | | | |
| Nonaccruing troubled debt restructurings: | | | |
| Commercial and industrial | **$ 490** | **$ 485** | **$ 210** |
| Commercial real estate | **1,304** | **1,304** | **986** |
| Commercial real estate construction | **1,548** | **1,541** | **828** |
| Total nonaccruing troubled debt restructurings | **3,342** | **3,330** | **2,024** |
| Accruing troubled debt restructurings: | | | |
| Commercial real estate | **4,577** | **4,577** | **4,549** |
| Residential mortgages | **336** | **336** | **327** |
| Total accruing troubled debt restructurings | **4,913** | **4,913** | **4,876** |
| Total troubled debt restructurings | **$ 8,255** | **$ 8,243** | **$ 6,900** |
| **DECEMBER 31, 2011** | | | |
| Nonaccruing troubled debt restructurings: | | | |
| Commercial and industrial | $ 490 | $ 485 | $ 234 |
| Commercial real estate | 656 | 656 | 412 |
| Commercial real estate construction | 1,548 | 1,541 | 850 |
| Total troubled debt restructurings | $ 2,694 | $ 2,682 | $ 1,496 |

All of the Corporation s troubled debt restructured loans are also 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. An additional charge-off in the amount of $39,000 occurred during the first quarter of 2012. As of June 30, 2012, there were no defaulted troubled debt restructurings 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, one was negotiated during 2011, while the other three were negotiated during 2012.

There are forbearance agreements on all loans currently classified as troubled debt restructurings, 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.

The following table presents the classes of the loan portfolio summarized by the past due status as of June 30, 2012 and December 31, 2011:

| In thousands | 30-59 Days Past Due | 60-89 Days Past Due | Nonaccrual and >90 Days Past Due | Total Past Due | Current | Total Loans Receivable | Loans Receivable >90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| **JUNE 30, 2012** | | | | | | | |
| Commercial and industrial | **$ 17** | **$** | **$ 222** | **$ 239** | **$ 50,771** | **$ 51,010** | **$** |
| Commercial real estate | **290** | | **5,417** | **5,707** | **229,267** | **234,974** | |
| Commercial real estate construction | | | **920** | **920** | **18,135** | **19,055** | |
| Residential mortgage | **524** | **750** | **2,063** | **3,337** | **316,058** | **319,395** | **892** |
| Home equity lines of credit | **158** | **41** | | **199** | **51,974** | **52,173** | |
| Consumer | **10** | | | **10** | **15,689** | **15,699** | |
| | **$ 999** | **$ 791** | **$ 8,622** | **$ 10,412** | **$ 681,894** | **$ 692,306** | **$ 892** |
| | | | | | | | |
| **DECEMBER 31, 2011** | | | | | | | |
| 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 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 credit | 397 | | 163 | 560 | 51,972 | 52,532 | 163 |
| Consumer | 20 | 8 | | 28 | 15,723 | 15,751 | |
| | $ 5,356 | $ 5,601 | $ 14,037 | $ 24,994 | $ 669,474 | $ 694,468 | $ 1,191 |

The following tables summarize the allowance for loan losses and recorded investment in loans receivable:

| In thousands | Commercial and Industrial | Commercial Real Estate | Commercial Real Estate Construction | Residential Mortgage | Home Equity Lines of Credit | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| **AS OF AND FOR THE PERIODS ENDED JUNE 30, 2012** | | | | | | | | |
| **Allowance for Loan Losses** | | | | | | | | |
| Beginning balance - April 1, 2012 | **$ 1,759** | **$ 6,419** | **$ 541** | **$ 3,667** | **$ 546** | **$ 464** | **$ 1,142** | **$ 14,538** |
| Charge-offs | **(93)** | | **(380)** | **(9)** | | **(13)** | | **(495)** |
| Recoveries | **6** | | **148** | | | | | **154** |
| Provisions | **(157)** | **(50)** | **228** | **(25)** | **(24)** | **54** | **1,099** | **1,125** |
| Ending balance - June 30, 2012 | **$ 1,515** | **$ 6,369** | **$ 537** | **$ 3,633** | **$ 522** | **$ 505** | **$ 2,241** | **$ 15,322** |
| | | | | | | | | |
| Beginning balance - January 1, 2012 | **$ 2,582** | **$ 6,007** | **$ 548** | **$ 3,624** | **$ 507** | **$ 419** | **$ 1,795** | **$ 15,482** |
| Charge-offs | **(2,087)** | **(39)** | **(380)** | **(209)** | **(51)** | **(51)** | | **(2,817)** |
| Recoveries | **8** | **250** | **148** | | | **1** | | **407** |
| Provisions | **1,012** | **151** | **221** | **218** | **66** | **136** | **446** | **2,250** |
| Ending balance - June 30, 2012 | **$ 1,515** | **$ 6,369** | **$ 537** | **$ 3,633** | **$ 522** | **$ 505** | **$ 2,241** | **$ 15,322** |
| Ending balance: individually evaluated for impairment | **$** | **$ 274** | **$** | **$** | **$** | **$** | **$** | **$ 274** |
| Ending balance: collectively evaluated for impairment | **$ 1,515** | **$ 6,095** | **$ 537** | **$ 3,633** | **$ 522** | **$ 505** | **$ 2,241** | **$ 15,048** |
| | | | | | | | | |
| **Loans Receivable** | | | | | | | | |
| Ending balance | **$ 51,010** | **$ 234,974** | **$ 19,055** | **$ 319,395** | **$ 52,173** | **$ 15,699** | **$** | **$ 692,306** |
| Ending balance: individually evaluated for impairment | **$ 222** | **$ 9,964** | **$ 922** | **$ 1,498** | **$** | **$** | **$** | **$ 12,606** |
| Ending balance: collectively evaluated for impairment | **$ 50,788** | **$ 225,010** | **$ 18,133** | **$ 317,897** | **$ 52,173** | **$ 15,699** | **$** | **$ 679,700** |
| | | | | | | | | |
| **AS OF AND FOR THE PERIODS ENDED JUNE 30, 2011** | | | | | | | | |
| **Allowance for Loan Losses** | | | | | | | | |
| Beginning Balance - April 1, 2011 | $ 1,230 | $ 6,007 | $ 1,295 | $ 3,360 | $ 395 | $ 415 | $ 1,633 | $ 14,335 |
| Charge-offs | (54) | (509) | (326) | (56) | | (18) | | (963) |
| Recoveries | 17 | | | 1 | | | | 18 |
| Provisions | 741 | 689 | (393) | 276 | (30) | (7) | 34 | 1,310 |
| Ending balance - June 30, 2011 | $ 1,934 | $ 6,187 | $ 576 | $ 3,581 | $ 365 | $ 390 | $ 1,667 | $ 14,700 |
| | | | | | | | | |
| Beginning Balance - January 1, 2011 | $ 2,074 | $ 6,346 | $ 1,154 | $ 3,108 | $ 341 | $ 520 | $ 1,709 | $ 15,252 |
| Charge-offs | (623) | (1,135) | (1,078) | (120) | | (25) | | (2,981) |
| Recoveries | 17 | | | 2 | | | | 19 |
| Provisions | 466 | 976 | 500 | 591 | 24 | (105) | (42) | 2,410 |
| Ending balance - June 30, 2011 | $ 1,934 | $ 6,187 | $ 576 | $ 3,581 | $ 365 | $ 390 | $ 1,667 | $ 14,700 |
| Ending balance: individually evaluated for impairment | $ | $ 15 | $ | $ 193 | $ | $ | $ | $ 208 |
| Ending balance: collectively evaluated for impairment | $ 1,934 | $ 6,172 | $ 576 | $ 3,388 | $ 365 | $ 390 | $ 1,667 | $ 14,492 |
| | | | | | | | | |
| **Loans Receivable** | | | | | | | | |
| Ending balance | $ 58,898 | $ 227,624 | $ 22,992 | $ 292,780 | $ 51,036 | $ 15,022 | $ | $ 668,352 |
| Ending balance: individually evaluated for impairment | $ 338 | $ 6,405 | $ 3,525 | $ 1,754 | $ | $ | $ | $ 12,022 |
| Ending balance: collectively evaluated for impairment | $ 58,560 | $ 221,219 | $ 19,467 | $ 291,026 | $ 51,036 | $ 15,022 | $ | $ 656,330 |
| | | | | | | | | |
| **AS OF DECEMBER 31, 2011** | | | | | | | | |
| **Allowance for Loan Losses** | | | | | | | | |

| | | | | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Ending balance | $ | 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 |
| | | | | | | | | | | | | | | | | | | | | |
| **Loans Receivables** | | | | | | | | | | | | | | | | | | | | |
| 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 |

9. **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.

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.

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis on measurement used at June 30, 2012, and December 31, 2011, are as follows:

| | | Fair Value Measurements at June 30, 2012 | | | |
|---|---|---|---|---|---|
| **In thousands** | **Basis** | **Total** | **Level 1** | **Level 2** | **Level 3** |
| U.S. Government and agencies | | **$ 29,333** | **$** | **$ 29,333** | **$** |
| Mortgage-backed securities | | **98,312** | | **98,312** | |
| State and municipal | | **51,897** | | **51,897** | |
| Corporate bonds | | **7,293** | | **7,293** | |
| CRA mutual fund | | **1,095** | **1,095** | | |
| Stock in other banks | | **781** | **781** | | |
| Total securities available for sale | **Recurring** | **$ 188,711** | **$ 1,876** | **$ 186,835** | **$** |
| Impaired loans | **Nonrecurring** | **$ 3,386** | **$** | **$** | **$ 3,386** |
| Foreclosed assets held for resale | **Nonrecurring** | **$ 1,177** | **$** | **$** | **$ 1,177** |

| | | 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 | | |
| Total securities available for sale | Recurring | $ 209,227 | $ 1,835 | $ 207,392 | $ |
| Impaired loans | Nonrecurring | $ 8,075 | $ | $ | $ 8,075 |
| Foreclosed assets held for resale | Nonrecurring | $ 1,176 | $ | $ | $ 1,176 |

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 certain of the Corporation s assets and liabilities at June 30, 2012, and December 31, 2011:

**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 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 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.

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

The fair values of 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 and/or charge-offs.

**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 upon 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 amounts of accrued interest receivable and accrued interest payable approximate their 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, 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 June 30, 2012, and December 31, 2011, were as follows:

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| **In thousands** | **Carrying Amount** | **Fair Value** | **Carrying Amount** | **Fair Value** |
| Financial assets: | | | | |
| Cash and due from banks | **$ 13,620** | **$ 13,620** | $ 14,423 | $ 14,423 |
| Interest bearing deposits in banks | **53,605** | **53,605** | 8,200 | 8,200 |
| Investment securities: | | | | |
| Available for sale | **188,711** | **188,711** | 209,227 | 209,227 |
| Held to maturity | **28,388** | **29,011** | 10,032 | 10,680 |
| Loans held for sale | **1,540** | **1,540** | 337 | 337 |
| Loans, less allowance for loan losses | **676,984** | **709,889** | 678,986 | 710,671 |
| Accrued interest receivable | **3,446** | **3,446** | 3,674 | 3,674 |
| Restricted investment in bank stocks | **6,478** | **6,478** | 7,146 | 7,146 |
| | | | | |
| Financial liabilities: | | | | |
| Deposits | **817,962** | **819,773** | 782,795 | 784,784 |
| Short-term borrowings | **42,601** | **42,601** | 45,962 | 45,962 |
| Long-term borrowings | **80,074** | **83,302** | 71,191 | 75,792 |
| Accrued interest payable | **1,205** | **1,205** | 1,429 | 1,429 |
| | | | | |

Off-balance sheet financial instruments

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Corporation s financial instruments as of June 30, 2012. This table excludes financial instruments for which the carrying amount approximates fair value.

| | | Fair Value Measurements at June 30, 2012 | | | |
|---|---|---|---|---|---|
| **In thousands** | **Carrying Amount** | **Fair value** | **Level 1** | **Level 2** | **Level 3** |
| Financial assets: | | | | | |

| | | | | |
|---|---|---|---|---|
| Investment securities held to maturity | **$ 28,388** | **$ 29,011** | **$ 29,011** | |
| Loans, less allowance for loan losses | **676,984** | **709,889** | | **709,889** |
| Financial liabilities: | | | | |
| Time deposits | **286,253** | **288,064** | **288,064** | |
| Long-term borrowings | **80,074** | **83,302** | **83,302** | |

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Corporation has utilized Level 3 inputs to determine fair value:

| | | Quantitative Information about Level 3 Fair Value Measurements | | | | |
|---|---|---|---|---|---|---|
| **In thousands** | **Fair Value Estimate** | **Valuation Technique** | | **Unobservable Input** | | **Range** |
| June 30, 2012 | | | | | | |
| Impaired loans | **$ 3,386** | **Appraisal of collateral** | **(1)** | **Appraisal adjustments** | **(2)** | **10 - 50%** |
| Foreclosed assets held for resale | **$ 1,177** | **Appraisal of collateral** | **(1) (3)** | **Appraisal adjustments** | **(2)** | **10 - 50%** |

(1) Fair value is generally determined through independent third-party appraisals of the underlying collateral, which generally includes various level 3 inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

(3) Includes qualitative adjustments by management and estimated liquidation expenses.

10. **New Accounting Pronouncements**

There were no new accounting pronouncements affecting the Corporation during the reporting periods.

**ACNB CORPORATION**

**ITEM 2 - MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**INTRODUCTION AND FORWARD-LOOKING STATEMENTS**

**Introduction**

The following is management s discussion and analysis of the significant changes in the financial condition, results of operations, comprehensive income, 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.

**Forward-Looking Statements**

In addition to historical information, this Form 10-Q 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 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 merger-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 Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and any Current Reports on Form 8-K.

**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 their value. Declines in fair value that are determined to be other than temporary are charged against earnings.

Accounting Standard 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 of its recorded 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 for impairment when such events occur. The Corporation has not identified any such events and, accordingly, has not tested goodwill for impairment during the six months ended June 30, 2012. During the quarter ended June 30, 2012, the Corporation changed its method of applying ASC 350 such that the annual goodwill impairment testing date will be changed from December 31st to October 1st. This new testing date is preferable in the circumstances, because it will allow the Corporation more time to accurately complete its impairment testing process in order to incorporate the results in its annual consolidated financial statements and timely file those statements with the Securities and Exchange Commission in accordance with its accelerated filing requirements. 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.

**RESULTS OF OPERATIONS**

**Quarter ended June 30, 2012, compared to quarter ended June 30, 2011**

*Executive Summary*

Net income for the three months ended June 30, 2012, was $2,128,000 compared to $2,106,000 for the same quarter in 2011, an increase of $22,000 or 1%. Earnings per share was $0.35 in 2012 and $0.36 in 2011. Net interest income decreased $26,000 or less than 1%, as decreases in interest income were not matched by decreases in interest expense. Provision for loan losses decreased $185,000 or 14% based on adequacy analysis of the Allowance for Loan Losses at the end of each period. Other income increased $58,000 or 2% due to a trust department estate fee and higher quarter-over-quarter fees from sold mortgages; both are sporadic in nature and lower year-over-year. Other expenses increased $187,000 or 2% due to increased full-time equivalent employees and higher pension expense.

*Net Interest Income*

Net interest income totaled $8,568,000 for the quarter ended June 30, 2012, compared to $8,594,000 for the same period in 2011, a decrease of $26,000 or less than 1%. Net interest income decreased due to a decrease in interest income to a greater degree than the decrease in interest expense, both resulting from reductions in market rates associated with the continued low rates maintained by the Federal Reserve Bank. Interest income decreased $325,000, or 3%, due to declines in the Federal Funds Target Rate and other market driver rates. These driver rates are indexed to a portion of the loan portfolio in that a decrease in the driver rates decreases the yield on the loans at subsequent interest rate reset dates. In this manner, interest income will continue to decrease as new loans replace paydowns on existing loans and variable rate loans reset to new lower rates. In addition, interest income was lower as a result of investment securities paydowns that were reinvested at much lower market rates resulting from slow domestic and even worse European economic conditions, compounded by Federal Reserve Bank buying activities. A significant share of earning assets was left in short-term money market type accounts because of interest rate risk and liquidity tolerances set for

the current mix of deposit funding sources. As to funding costs, alternative funding sources, such as the Federal Home Loan Bank (FHLB), and other market driver rates are factors in rates the Corporation and the local market pay for deposits. However, during the second quarter of 2012, several of the core deposit rates continued at practical floors after the Federal Open Market Committee decreased the Federal Funds Target Rate by 400 basis points during 2008 and has maintained it at 0% to 0.25% since that time.

Interest expense decreased $299,000 or 16%. For more information about interest rate risk, please refer to Item 7A - Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K for the fiscal year-ended December 31, 2011, and filed with the SEC on March 12, 2012. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the second quarter of 2012 was 3.49% compared to 3.65% during the same period in 2011. Also comparing the second quarter of 2012 to 2011, the yield on interest earning assets decreased by 0.34% and the cost of interest bearing liabilities decreased by 0.18%. The net interest margin was 3.62% for the second quarter of 2012 and 3.79% for the second quarter of 2011. The net interest margin decline was mainly a result of the rate of decline in the yield on assets decreasing to a greater degree than the decline in funding rates due to rates approaching practical floors on deposits as described above.

Average earning assets were $953,032,000 during the second quarter of 2012, an increase of $41,129,000 from the average for the second quarter of 2011. Average interest bearing liabilities were $803,802,000 in the second quarter of 2012, an increase of $29,071,000 from the same quarter in 2011.

*Provision for Loan Losses*

The provision for loan losses was $1,125,000 in the second quarter of 2012 compared to $1,310,000 in the second quarter of 2011, a decrease of $185,000 or 14%. The decrease was a result of analysis of the adequacy of the allowance for loan losses. Each quarter, the Corporation measures risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors. For more information, please refer to *Allowance for Loan Losses* in the following Financial Condition section of this part. ACNB charges confirmed loan losses to the allowance and credits the allowance for recoveries of previous loan charge-offs. For the second quarter of 2012, the Corporation had net charge-offs of $341,000, as compared to net charge-offs of $945,000 for the second quarter of 2011.

*Other Income*

Total other income was $3,065,000 for the three months ended June 30, 2012, up $58,000, or 2%, from the second quarter of 2011. Fees from deposit accounts increased by less than $1,000, or 0%, due to higher monthly fees (from volume increases) offsetting lower non-sufficient funds fee volume. Government regulation limits fee assessments, making future revenue levels uncertain. Revenue from ATM and debit card transactions increased 1% to $323,000 due to higher volume. The increase resulted from consumer desire to use more electronic delivery channels; however, government regulations for large financial institutions may impact industry pricing for such transactions in future periods, the effect of which cannot be currently quantified. Income from fiduciary activities, which include both institutional and personal trust management services, totaled $356,000 for the three months ended June 30, 2012, as compared to $329,000 during the second quarter of 2011, an 8% increase as a result of higher estate fee income in the second quarter of 2012. Earnings on bank-owned life insurance decreased by $9,000, or 4%, as a result of variations in crediting rates. The Corporation s wholly-owned subsidiary, Russell Insurance Group, Inc. (RIG), earned revenue of $1,295,000 this quarter, similar to the $1,308,000 in the same quarter in 2011. This stability was due to personal lines commissions, as commercial lines revenue in the longer term is down in a soft insurance market and from the effects of the prolonged economic slowdown on business clients. Other income in the quarter ended June 30, 2012, was higher due to fees related to sales of residential mortgages in 2012, which continues to be lower for the year to date.

*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 future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount in 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 consolidated statement of condition 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. During the quarter ended June 30, 2012, the Corporation changed its method of applying ASC 350 such that the annual goodwill impairment testing date will be changed from December 31st to October 1st. This new testing date is preferable in the circumstances, because it will allow the Corporation more time to accurately complete its impairment testing process in order to incorporate the results in its annual consolidated financial statements and timely file those statements with the Securities and Exchange Commission in accordance with its accelerated filing requirements. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. 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. If the entity determines that it is more likely than not that the fair value has fallen below its carrying value, then 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 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. For the year ended December 31, 2011, compared to 2010, commissions from insurance sales decreased by 3%, while agency expenses decreased by 8%. RIG s stand-alone net income increased by 50% in 2011 compared to 2010. Since the testing for potential impairment involves methods that include current and projected income amounts as well as market average multiples paid for similar agencies, 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 cash flow estimates of likely buyers that are assumed in impairment testing, may require an impairment charge to goodwill. A liability incurred at year-end 2011 and paid in the first quarter of 2012 for contingent consideration owed on the previous purchase of another insurance agency did not unfavorably impact the fair value of RIG. 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 such determination is made.

*Other Expenses*

The largest component of other expenses is salaries and employee benefits, which increased by $337,000, or 8%, when comparing the second quarter of 2012 to the same quarter a year ago. Overall, the net increase in salaries and employee benefits was the result of:

- increases from normal promotion and production-based incentive/bonus compensation to employees;

- an increase in the number of full-time equivalent employees, including those hired for the opening of a new retail banking office;

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- increased payroll taxes including higher unemployment tax assessments;

- increased cost associated with employee benefit plans; and,

- increased defined benefit pension expense, which is up by $142,000 when comparing the three months ended June 30, 2012, to June 30, 2011, resulting from low 2011 investment performance and a significant decrease in the discount rate from the Federal Reserve Bank s multi-year policy of keeping market rates at historically low levels.

The Corporation s overall pension 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 upcoming benefit expense is also dependent on the expected return on assets and the discount rate on the year-end measurement date; specifically, with low discount rates and fair value volatility, the expense can be negatively impacted by conditions on that particular measurement date. In addition, the Corporation amended the defined benefit pension plan effective April 1, 2012, in that no employee hired after March 31, 2012, shall be eligible to participate in the plan. A pension provision in a public law known as MAP-21 enacted in July 2012 will have no effect on reducing the GAAP expense associated with the pension plan in upcoming periods as the ACNB plan has been in the past and continues to have well-funded status.

Net occupancy expense decreased by $3,000, less than 1%, due to variation in seasonal factors. Equipment expense decreased by $11,000, or 2%, as a result of fewer replacement equipment and software purchases in 2012 compared to 2011.

Professional services expense totaled $251,000 during the second quarter of 2012, as compared to $261,000 for the same period in 2011, a decrease of $10,000 or 4%. The decrease was due to less vendor engagements conducted in 2012 compared to 2011.

Marketing and corporate relations expenses decreased by $38,000, or 30%, in the second quarter of 2012 compared to the same period of 2011. Lower marketing expense in 2012 reflected varying levels of advertising production and media expenditures in accordance with the marketing plan.

FDIC expense for the second quarter of 2012 was $192,000, a decrease of $122,000 from the second quarter of 2011. The decrease was due in part to improved risk ratings and a revised computation method. Over the last several years, 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 the severe recession. At the end of the third quarter of 2009, the FDIC announced a plan in which most banks prepaid an estimated three years of regular quarterly premiums at year-end 2009, as opposed to a special assessment similar to which was levied on all insured banks in the second quarter of 2009. The prepaid assessments did not immediately affect ACNB earnings. ACNB recorded its prepaid assessments as a prepaid expense (an asset) as of December 30, 2009, in the amount of $3,956,000, the date the payment was made. For the quarter ended 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 would be made to the FDIC at the end of the following quarter. Even though an estimated premium is prepaid under this plan, the actual expense will vary based on several factors 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 $165,000 and $143,000 for the quarters ended June 30, 2012 and 2011, respectively. The 2012 expense was higher due a specific property write-down based on an accepted offer and subsequent pending sales contract on a larger property. The higher cost in both years, compared to earlier periods, 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 the prolonged marketing cycles for these distressed properties. 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.

Other tax expenses decreased by $5,000, or 3%, due to sales tax refunds offsetting an increase in a state shareholders equity-based tax that increases annually regardless of income. Supplies and postage decreased by $14,000, or 8%, due to timing on larger supply refills. Other operating expenses increased by $25,000, or 3%, in the second quarter of 2012, as compared to the second quarter of 2011. The increases were in a variety of expense categories including the cost of an expanded electronic banking option.

*Provision for Income Taxes*

The Corporation recognized income taxes of $540,000, or 20% of pretax income, during the second quarter of 2012, as compared to $532,000, or 20% of pretax income, during the same period in 2011. The variances from the federal statutory rate of 34% in both periods 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 income tax provision during the second quarters ended June 30, 2012 and 2011 included low-income housing tax credits of $139,000.

**Six months ended June 30, 2012, compared to six months ended June 30, 2011**

*Executive Summary*

Net income for the six months ended June 30, 2012, was $4,364,000 compared to $4,566,000 for the same six months in 2011, a decrease of $202,000 or 4%. Earnings per share was $0.73 in 2012 and $0.77 in 2011 for the respective six month periods. Net interest income increased $50,000 or less than 1%, as the decrease in interest expense was higher than the decrease in interest income. Provision for loan losses decreased $160,000 or 7% based on adequacy analysis of the Allowance for Loan Losses at the end of each period. Other income decreased $83,000 or 1% due to less trust department revenue and less fees from sold mortgages. Other expenses increased $507,000 or 3% due to higher full-time equivalent employees and higher pension. In addition, expenses on foreclosed real estate were not significantly higher in 2012.

*Net Interest Income*

Net interest income totaled $17,208,000 for the six months ended June 30, 2012, compared to $17,158,000 for the same period in 2011, an increase of $50,000 or less than 1%. Net interest income increased due to a decrease in interest expense to a slightly greater degree than the decrease in interest income, both resulting from reductions in market rates associated with the continued low rates due to economic conditions and actions by the Federal Reserve Bank. Interest income decreased $534,000, or 3%, due to declines in the Federal Funds Target Rate and other market driver rates. These driver rates are indexed to a portion of the loan portfolio in that a decrease in the driver rates decreases the yield on the loans at subsequent interest rate reset dates. In this manner, interest income will continue to decrease as new loans replace paydowns on existing loans and variable rate loans reset to new lower rates. In addition, interest income was lower as a result of investment securities paydowns that were reinvested at much lower market rates resulting from domestic and foreign economic conditions and reinforced by Federal Reserve Bank buying activities. Some earning assets were left in short-term market type accounts because of the interest rate risk and liquidity

tolerances set for the current mix of deposit funding sources. As to deposit funding costs, alternative funding sources, such as the Federal Home Loan Bank (FHLB), and other market driver rates are factors in rates the Corporation and the local market pay for deposits. However, during the second quarter of 2012, several of the core deposit rates continued at practical floors after the Federal Open Market Committee decreased the Federal Funds Target Rate by 400 basis points during 2008 and has maintained it at 0% to 0.25% since that time. Interest expense decreased $584,000 or 15%. For more information about interest rate risk, please refer to Item 7A - Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K for the fiscal year-ended December 31, 2011, and filed with the SEC on March 12, 2012. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the first six months of 2012 was 3.54% compared to 3.72% during the same period in 2011. Also comparing the first six months of 2012 to 2011, the yield on interest earning assets decreased by 0.37% and the cost of interest bearing liabilities decreased by 0.19%. The net interest margin was 3.67% for the second quarter of 2012 and 3.87% for the first six months of 2011. The net interest margin decline was mainly a result of the rate of decline in the yield on assets decreasing to a greater degree than the decline in funding rates due to absolute low rates on deposits as described above.

Average earning assets were $943,088,000 during the first six months of 2012, an increase of $45,120,000 from the average for the first six months of 2011. Average interest bearing liabilities were $797,516,000 in the first six months of 2012, an increase of $30,869,000 from the same six months in 2011.

*Provision for Loan Losses*

The provision for loan losses was $2,250,000 in the first six months of 2012 compared to $2,410,000 in the first six months of 2011, a decrease of $160,000 or 7%. The decrease was a result of analysis of the adequacy of the allowance for loan losses. Each quarter, the Corporation measures risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors. For more information, please refer to *Allowance for Loan Losses* in the subsequent Financial Condition section. ACNB charges confirmed loan losses to the allowance and credits the allowance for recoveries of previous loan charge-offs. For the first six months of 2012, the Corporation had net charge-offs of $2,410,000, as compared to net charge-offs of $2,962,000 for the first six months of 2011.

*Other Income*

Total other income was $5,881,000 for the six months ended June 30, 2012, down $83,000, or 1%, from the first six months of 2011. Fees from deposit accounts decreased by $11,000, or 1%, due to varying volume. Government regulation limits fee assessments, making future revenue levels uncertain. Revenue from ATM and debit card transactions increased 6% to $632,000 due to higher volume. The increase resulted from consumer desire to use more electronic delivery channels; however, government regulations for large financial institutions may impact industry pricing for such transactions in future periods, the effect of which cannot be currently quantified. Income from fiduciary activities, which include both institutional and personal trust management services, totaled $644,000 for the six months ended June 30, 2012, as compared to $702,000 during the first six months of 2011, an 8% decrease as a result of lower average asset market values under management. Earnings on bank-owned life insurance decreased by $8,000, or 2%, as a result of variations in crediting rates. The Corporation s wholly-owned subsidiary, Russell Insurance Group, Inc. (RIG), saw revenue stable at $2.5 million in both periods. This stability was due to higher personal lines revenue mostly offsetting lower commercial lines as revenue from a soft insurance market was combined with the effects of the prolonged economic slowdown on business clients. Other income in the six months ended June 30, 2012, was lower due to decreased fees related to sales of residential mortgages in first six months of 2012.

*Other Expenses*

The largest component of other expenses is salaries and employee benefits, which increased by $780,000, or 9%, when comparing the first six months of 2012 to the same period a year ago. Overall, the net increase in salaries and employee benefits was the result of:

- increases from normal promotion and production-based incentive/bonus compensation to employees;

- an increase in the number of full-time equivalent employees, including those hired for the opening of a new retail banking office;

- increased payroll taxes including higher unemployment tax assessments;

- increased cost associated with employee benefit plans; and,

- increased defined benefit pension expense, which is up by $284,000 when comparing the six months ended June 30, 2012, to June 30, 2011, resulting from low 2011 investment performance and a significant decrease in the discount rate from the Federal Reserve Bank s multi-year policy of keeping market rates at historically low levels.

The Corporation s overall pension 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 upcoming benefit expense is also dependent on the expected return on assets and the discount rate on the year-end measurement date; specifically, with low discount rates and fair value volatility, the expense can be negatively impacted by conditions on that particular measurement date. In addition, the Corporation amended the defined benefit pension plan effective April 1, 2012, in that no employee hired after March 31, 2012, shall be eligible to participate in the plan. A pension provision in a public law known as MAP-21 enacted in July 2012 will have no effect on reducing the GAAP expense associated with the pension plan in upcoming periods as the ACNB plan has been in the past and continues to have well-funded status.

Net occupancy expense decreased by $66,000, or 6%, in part due to a mild and relatively snow-free winter season in 2012. Equipment expense decreased by $62,000, or 5%, as a result of fewer replacement equipment and software purchases in 2012 compared to 2011.

Professional services expense totaled $442,000 during the first six months of 2012, as compared to $470,000 for the same period in 2011, a decrease of $28,000 or 6%. The decrease was due to less vendor engagements conducted to date in 2012 compared to the first half of 2011 and expenses migrating from this category to foreclosed asset categories in 2012.

Marketing and corporate relations expenses decreased by $62,000, or 25%, in the first six months of 2012 compared to the same period of 2011. Lower marketing expense in 2012 reflected varying levels advertising production and media expenditures in accordance with the marketing plan.

FDIC expense for the first six months of 2012 was $402,000, a decrease of $286,000 from the same period in 2011. The decrease was due in part to improved risk ratings and a revised computation method. Over the last several years, 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 the severe recession. At the end of the third quarter of 2009, the FDIC announced a plan in which most banks prepaid an estimated three years of regular quarterly premiums at year-end 2009, as opposed to a special assessment similar to which was levied on all insured banks in the second quarter of 2009. The prepaid assessments did not immediately affect ACNB earnings. ACNB recorded its prepaid assessments as a prepaid expense (an asset) as of December 30, 2009, in the amount of $3,956,000, the date the payment was made. For the quarter ended 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 would be made to the FDIC at the end of the following quarter. Even though an estimated premium is prepaid under this plan, the actual expense will vary based on several factors 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 $230,000 and $10,000 for the six months ended June 30, 2012 and 2011, respectively. The 2011 amount was net of a $194,000 gain on the sale of one commercial real estate participation loan in the first quarter. The higher cost in 2012 was also due to the increased number and varying mix of commercial and residential collateral, unpaid property taxes, legal expenses, and deferred maintenance required upon acquisition. In addition, some properties suffered decreases in value after acquisition, requiring write-downs to fair value, during the prolonged marketing cycles for these distressed properties. 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.

Other tax expenses increased by $10,000, or 3%, due to a state equity-based tax that increases annually regardless of income. Supplies and postage increased by $7,000, or 2%, due to timing on larger supply refills. Other operating expenses decreased by $3,000, or less than 1%, in the first six months of 2012, as compared to the first six months of 2011. The decreases were in a variety of expense categories.

*Provision for Income Taxes*

The Corporation recognized income taxes of $1,096,000, or 20% of pretax income, during the first six months of 2012, as compared to $1,274,000, or 22% of pretax income, during the same period in 2011. The variances from the federal statutory rate of 34% in both periods 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 income tax provision during the six months ended June 30, 2012 and 2011 included low-income housing tax credits of $278,000.

**FINANCIAL CONDITION**

Assets totaled $1,047,319,000 at June 30, 2012, compared to $1,004,823,000 at December 31, 2011, and $998,337,000 at June 30, 2011. Average earning assets during the six months ended June 30, 2012, increased to $943,088,000 from $897,968,000 during the same period in 2011. Average interest bearing liabilities increased in 2012 to $797,516,000 from $766,647,000 in 2011, while average non-interest bearing deposits increased by $3,182,000.

*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 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 statement of condition.

At June 30, 2012, the securities balance included a net unrealized gain of $5,970,000, net of taxes, on available for sale securities versus a net unrealized gain of $5,996,000, net of taxes, at December 31, 2011, and a net unrealized gain of $4,992,000, net of taxes, at June 30, 2011. The increase in fair value of securities from June 30, 2011, was a result of change in the portfolio s interest rate sensitivity position and 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. Slow economic conditions domestically and abroad and the actions by the Federal Reserve to stimulate the housing market and lessen the impact of the recession are affecting the spread and currently generally increasing the value of the securities held by ACNB. An eventual return to higher market rates will further negatively affect the fair value; however the investments will be expected to continue to pay the contractual interest rate and return of the principal over the life of the investment or at maturity. 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 security but rather relying on the security s relationship to other benchmark quoted prices. The Corporation uses a reliable service provider to provide matrix pricing and uses the valuation of another provider to compare for reasonableness. Please refer to Note 7 - *Securities* in the Notes to Consolidated Financial Statements for more information on the security portfolio and Note 9 - *Fair Value Measurements* in the Notes to Consolidated Financial Statements for more information about fair value.

*Loans*

Loans outstanding increased by $23,954,000, or 3.6%, from June 30, 2011, to June 30, 2012, but decreased by $2,162,000, or less than 1%, from December 31, 2011, to June 30, 2012. The increase in loan volume was the result of determined efforts to lend to creditworthy borrowers despite the continued slow economic conditions. The decrease from year end 2011 to June 30, 2012, was the result of approximately $10 million in local government loans paying off with proceeds from that unit issuing municipal bonds. Compared to December 31, 2011, commercial loans (including loans to local government units) decreased by approximately $5,135,000 or 9%.

Other than the payoff mentioned above, the commercial loan decrease during this period was the result of competing for available loans in the market, even while reduced business activity in the market area hindered new originations. Commercial real estate loans decreased by $1,043,000, or less than 1%, while real estate construction loans decreased by $3,702,000, or 16%. New housing development activity is currently very limited in the marketplace, and this category has decreased significantly since 2008. Residential mortgage loans and home equity lines of credit to consumers increased by $7,770,000, or 2%, even though many existing loans were refinanced elsewhere because of the low interest rate environment. The increase was a result of a marketing program to offer simplified real estate-secured consumer loans through the retail network. Even with marketing and retail banking staff efforts, other consumer loans were stable to slightly declining. Management has limited new participation credits in conjunction with other financial institutions, primarily due to potential credit risk. Participation loans at June 30, 2012, totaled approximately $22,000,000 compared to $25,000,000 at December 31, 2011. Residential mortgage loans secured by junior liens total approximately $28,000,000, or 8% of total residential mortgage loans. Home equity loans are also, in many cases, junior liens and totaled approximately $52,000,000 at June 30, 2012. Although there is no discernible difference in delinquency compared to first mortgage loans and comparative loss history, junior liens inherently have more credit risk by virtue of the fact that another financial institution might have a superior security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent in a continuation of the national or a local weak housing market.

Most of the Corporation s lending activities are with customers located within 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 $92,800,000, or 13% of total loans, at June 30, 2012. 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 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.

*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 for each of these loans 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 allocations on the average loss ratio for the previous twelve quarters 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;

- 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. In addition, management bases the provision for loan losses, if any, 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 or charge-down or charge-off specific allocations 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 allowance for loan losses at June 30, 2012, was $15,322,000, or 2.21% of loans, as compared to $14,700,000, or 2.20% of loans, at June 30, 2011, and $15,482,000, or 2.23% of loans, at December 31, 2011.

Changes in the allowance for loan losses were as follows:

| In thousands | Six Months Ended June 30, 2012 | Year Ended December 31, 2011 | Six Months Ended June 30, 2011 |
|---|---|---|---|
| Beginning balance - January 1 | **$ 15,482** | $ 15,252 | $ 15,252 |
| Provision charged to operations | **2,250** | 5,435 | 2,410 |
| Recoveries on charged-off loans | **407** | 38 | 19 |
| Loans charged-off | **(2,817)** | (5,243) | (2,981) |
| | | | |
| Ending balance | **$ 15,322** | $ 15,482 | $ 14,700 |

Loans past due 90 days and still accruing were $892,000 and nonaccrual loans were $7,730,000 as of June 30, 2012. $2,024,000 of the nonaccrual balance at June 30, 2012, were troubled debt restructured loans. $4,876,000 of the impaired loans were accruing troubled debt restructured loans. Loans past due 90 days and still accruing were $1,497,000 at June 30, 2011, while nonaccruals were $12,022,000. $1,734,000 of the nonaccrual balance at June 30, 2011, were troubled debt restructured loans.

Loans past due 90 days and still accruing were $1,191,000 at December 31, 2011, while nonaccruals were $12,846,000. $1,496,000 of the nonaccrual balance at December 31, 2011, were troubled debt restructured loans. Total additional loans classified as substandard (potential problem loans) at June 30, 2012, June 30, 2011, and December 31, 2011, were approximately $10,600,000, $14,862,000 and $10,807,000, respectively. There were no accruing troubled debt restructured loans as of June 30, 2011, and December 31, 2011.

A better understanding of the trends of the non-performing loans is obtained by a comparison back to previous periods. Information on nonaccrual loans at June 30, 2012, as compared to December 31, 2011 and 2010 is as follows:

| In thousands | Number of Credit Relationships | Balance | Specific Loss Allocations | Charge-Offs | Location | Originated | |
|---|---|---|---|---|---|---|---|
| **June 30, 2012** | | | | | | | |
| Residential real estate developments | **2** | **$ 922** | **$** | **381** | **In market** | **2006** | **2010** |
| Owner occupied commercial real estate | **15** | **3,053** | **31** | **83** | **In market** | **1995** | **2008** |
| Investment/rental commercial real estate | **7** | **3,545** | **243** | **24** | **In market** | **2003** | **2010** |
| Commercial and industrial | **1** | **210** | | **1,954** | **In market** | **2006** | **2007** |
| **Total** | **25** | **$ 7,730** | **$ 274** | **$ 2,442** | | | |
| | | | | | | | |
| **December 31, 2011** | | | | | | | |
| 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 |
| **Total** | 24 | $ 12,846 | $ 1,181 | $ 4,301 | | | |
| | | | | | | | |
| **December 31, 2010** | | | | | | | |
| 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 | |
| **Total** | 23 | $ 14,657 | $ 2,059 | $ 2,134 | | | |

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

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 between 1995 and 2010 for purposes listed in the classifications in the tables above.

At June 30, 2012, the Corporation had two impaired loans to unrelated borrowers totaling $828,000 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 discussed below were originated during the first half of 2006. Foreclosure has been held in abeyance while allowing the pursuit of a workout plan including providing additional collateral. Because of the length of time since the last sale, a $274,000 specific allocation was charged-off against the allowance for loan losses in 2011. Subsequently, $422,000 was applied to principal from property sales.

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There was no valuation allowance on this loan at June 30, 2012. One $6,000,000 loan matured with the inability of the borrower to make the necessary infrastructure improvements. The Corporation charged down the loan by $2,500,000 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 on the property and updated information, respectively. The various real estate collateral on this loan was protected by a fair value bid at sheriff sale in 2012 after the properties were reappraised, resulting in a $381,000 write down, the remaining balance was classified as foreclosed assets held for resale; the properties are being marketed to the appropriate buyers. The respective allowances and write-downs were derived by estimating the cash flow from the sale of the property given the respective stage of completion and/or the zoning without required infrastructure. From 2010 to 2011, three smaller residential real estate development loans were added to nonaccrual impaired loans. All three are in the Corporation s market area with standard terms and conditions and no interest reserves, but have suffered from the downturn in the real estate market. One of these loans remains at June 30, 2012, in the amount of $94,000 with no specific allocation. ACNB will protect its interests by fair value bid at sheriff sale, after which it will market the property to the appropriate buyers if the loan is not kept current by the borrower. The second loan was moved to foreclosed assets held for resale in the fourth quarter of 2011, and is currently being marketed for sale. The third loan was moved to foreclosed assets held for resale after a $77,000 charge-off, and was subsequently sold at a small gain in the third quarter of 2011.

Owner occupied commercial real estate at June 30, 2012, includes 15 loan relationships to unrelated borrowers which total $3,053,000, none of which exceeds $736,000 in outstanding balance. These loans were originated between 1995 and 2008. A $3,500,000 loan previously in this category was settled in the first quarter of 2012, and the Corporation realized a $250,000 recovery on a previous $598,000 charge-off. The other 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 of ACNB to initiate foreclosure procedures. One previous loan relationship in this category with a combined balance of $251,000 was paid in full by the borrower in the second quarter of 2012. Another loan with a balance of $230,000 had a partial charge-off of $39,000 in the first quarter 2012 based on a new appraised value. Another loan with a $44,000 balance was completely charged-off in the second quarter of 2012.

Investment/rental commercial real estate at June 30, 2012, includes seven unrelated loan relationships totaling $3,545,000 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, and were affected by the lack of borrower cash flow to continue to service the debt. The current plan is to enter foreclosure proceedings and subsequently market the real estate if ongoing workout efforts are not successful. One loan totaling $699,000, added in the second quarter of 2012 because of recent delinquency, had a specific allocation of $243,000 based on a current appraisal. This participation loan is related to the charged-off loan discussed below in commercial and industrial loans. Another unrelated loan totaling $843,000 to a single borrower had a specific allocation totaling $66,000 removed in the second quarter of 2012 based on a new appraised value less estimated costs to sell. Another group of rental properties total $724,000 to a single borrower remain in bankruptcy; moreover, as the rental properties do not cash flow and the borrower has indicated no further payments will be made, collection has commenced through the foreclosure process. Other investment/rental commercial real estate loans are in collection or are in various stages of the foreclosure process. $24,000 in charge-offs on another loan in this category was made when it was deemed that loss was confirmed by a new appraisal.

Included in impaired commercial and industrial loans at June 30, 2012, are related term loans and a fully-disbursed line of credit, all originated in the second quarter of 2007 for a start-up enterprise in the food industry in southcentral Pennsylvania, that total $210,000 at June 30, 2012, which is net of a $1,000,000 charge-off taken in 2008 and an additional $529,000 charge-off in 2011. These loans, with standard terms and conditions including repayment from conversion of trade assets, are in default and in nonaccrual status. The 2011 charge-off was taken after the borrower stated that no further payments are likely. Subsequently, the borrower entered into a forbearance agreement in the third quarter of 2011 that included a principal reduction of $106,000 to date. The remaining outstanding balance on this set of loans was derived by estimating the cash flow from the liquidation of personal and business assets pledged as collateral. A second credit to an unrelated borrower was added to nonaccrual in the third quarter of 2011 in the amount of $3,100,000, with a confirmed loss charged-off in the fourth quarter of 2011 of $1,135,000 plus a specific allocation of $1,085,000 derived by analyzing the latest company provided accounts receivable data.

In the first quarter of 2012, the lead bank for this participation loan reported that the remaining accounts receivable that secured this loan were deemed worthless and ACNB charged off the entire remaining $1,954,000. This 2006 participation loan was to a company in the building supplies industry that was negatively impacted by the downturn in housing and then the loss of its major distributorship.

As detailed above, 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 developed 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.

*Foreclosed Assets Held for Resale*

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. The carrying value of real estate acquired through foreclosure was 14 properties totaling $5,247,000 at June 30, 2012, compared to 17 properties totaling $4,437,000 at December 31, 2011. The increase was due to four related parcels from the residential real estate construction loan described above added in the second quarter of 2012, while seven residential properties were sold at a net loss (exclusive of holding expenses and interim writedowns) of $33,000. All properties are actively being marketed. The Corporation expects to obtain and market additional foreclosed assets through the remainder of 2012; however, the total amount and timing is currently not certain.

*Deposits*

ACNB continues to rely on its market area deposits as a primary source of funds for lending activities with total deposits of $817,962,000 as of June 30, 2012. Deposits increased by $48,562,000, or 6%, from June 30, 2011, to June 30, 2012, and by $35,167,000, or 4%, from December 31, 2011, to June 30, 2012. Deposits vary between quarters in mostly reflecting different levels held by local government and school districts during different times of the year. The second quarter ended June 30, 2012, had an additional increase due to the deposit of $20 million in bond proceeds from a major customer. The drawdown schedule for these deposits has not been finalized by the customer. 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. During the recession and subsequent slow recovery, deposit growth mix experienced a 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 regained balances. With continued low market interest rates in a low interest rate 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 improve, funds could leave the Corporation or be priced higher to maintain similar levels.

*Borrowings*

Short-term borrowings are comprised of securities sold under agreements to repurchase. Investment securities are pledged in sufficient amounts to collateralize these repurchase agreements, which are legally borrowings but similar to deposits. As of June 30, 2012, short-term borrowings were $42,601,000, as compared to $45,962,000 at December 31, 2011, and $47,924,000 at June 30, 2011. In comparison to year-end 2011, short-term borrowings were down due to changes in the cash flow position of ACNB s commercial and local government customer base. There were no short-term Federal Home Loan Bank (FHLB) borrowings at the end of any of the periods; although, they were used in the first quarter of 2012 to even out funding from seasonality in the deposit base. The average balance of the short-term borrowings with the FHLB was $0 during the second quarter of 2012.

Long-term borrowings consist primarily of advances from the FHLB. Long-term borrowings totaled $80,074,000 at June 30, 2012, versus $71,191,000 at December 31, 2011, and $76,305,000 at June 30, 2011. The Corporation increased long-term borrowings from year-end 2011, by converting a short-term borrowing into a two through four year laddered borrowing in order to lengthen liability duration and thereby reduce the negative effects of an increase in interest rates in that future time frame.

*Capital*

ACNB s capital management strategies have been developed to provide a dividend to stockholders, while maintaining its well-capitalized position. Total stockholders equity was $99,910,000 at June 30, 2012, compared to $97,474,000 at December 31, 2011, and $97,333,000 at June 30, 2011. Stockholders equity increased in the first six months of 2012 by $2,436,000 due to $2,104,000 in earnings retained in capital and an increase in accumulated other comprehensive income due to change in the fair value of the investment portfolio and the change in the net funded position of the defined benefit pension plan.

The primary source of additional capital to ACNB is earnings retention, which represents net income less dividends declared. During the first six months of 2012, ACNB earned $4,364,000 and paid dividends of $2,260,000 for a dividend payout ratio of 52%. During the first six months of 2011, ACNB earned $4,566,000 and paid dividends of $2,254,000 for a dividend payout ratio of 49%.

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. Year to date June 30, 2012, 9,726 shares were issued under this plan with proceeds in the amount of $141,000. Proceeds, as delineated in the plan s prospectus, will be used for general corporate purposes (including, but not limited to, the option of contributions to surplus of ACNB s banking subsidiary).

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 its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications 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 June 30, 2012, and December 31, 2011, 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 conditions or events since the notification that management believes have changed the banking subsidiary s category.

ACNB neither solicited nor received any government funds under the U.S. Treasury Troubled Asset Relief Program (TARP) Capital Purchase Program or the Small Business Lending Fund.

On June 12, 2012, regulatory agencies, including the FDIC, ACNB Bank s primary federal regulator, jointly issued requests for comments on notice of proposed rulemaking (NPR) that would revise and replace current capital rules. The proposals, generally called Basel III NPR, would add an additional set of capital ratios, raise the ratio requirements on another set and introduce the concept of capital buffers that could limit capital distributions or payment of certain discretionary bonuses. In addition, NPR would change certain components of the numerators and denominators of the ratios. ACNB currently exceeds the NPR and all equity currently is common stock, favored in the NPR. The changes in the denominators and numerators, in regards to residential mortgage loan weightings and the fair value of available for sale securities in particular, however are deemed by ACNB to add unnecessarily to complexity, increase ratio volatility and negatively affect net interest income. The comment period ends in September 2012 and provisions of the new rules could begin as early as January 2013, although a multi-year phase in is included in the NPR.

*Risk-Based Capital*

The banking subsidiary s capital ratios are as follows:

| | June 30, 2012 | December 31, 2011 | To Be Well Capitalized Under Prompt Corrective Action Regulations |
|---|---|---|---|
| Tier 1 leverage ratio (to average assets) | **8.30%** | 8.24% | 5.00% |
| Tier 1 risk-based capital ratio (to risk-weighted assets) | **12.81%** | 12.07% | 6.00% |
| Total risk-based capital ratio | **14.08%** | 13.32% | 10.00% |

*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 to cash and federal funds sold, 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 June 30, 2012, ACNB s banking subsidiary had a borrowing capacity of approximately $334,777,000 from the FHLB, of which $256,777,000 was available. Since the second half of 2008, financial institutions had experienced difficulties in bank-to-bank liquidity worldwide. ACNB has been insulated from the freeze in credit markets by its relationship with the FHLB, a government-sponsored enterprise regulated by the Federal Housing Finance Agency. 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 current 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, lowers 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 on any day they are needed for borrowing purposes.

Another source of liquidity is securities sold under repurchase agreements to customers of ACNB s banking subsidiary totaling approximately $42,601,000 and $45,962,000 at June 30, 2012, and December 31, 2011, respectively. These agreements vary in balance according to the cash flow needs of customers and competing accounts at other financial organizations.

The liquidity of the Corporation also represents an important aspect of liquidity management. The Corporation s cash outflows consist principally of dividends to stockholders and corporate expenses. The main source of funding for the Corporation 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 Corporation from subsidiary banks.

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.

*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 June 30, 2012, the Corporation had unfunded outstanding commitments to extend credit of approximately $133,000,000 and outstanding standby letters of credit of approximately $5,800,000.

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.

*Market Risks*

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.

**RECENT DEVELOPMENTS**

JUMPSTART OUR BUSINESS STARTUPS (JOBS) ACT **-** On April 5, 2012, President Obama signed the JOBS Act into law. The JOBS Act is aimed at facilitating capital raising by smaller companies and banks and bank holding companies by implementing the following changes:

- raising the threshold requiring registration under the Securities Exchange Act of 1934 (Exchange Act) for banks and bank holdings companies from 500 to 2,000 holders of record;

- raising the threshold for triggering deregistration under the Exchange Act for banks and bank holding companies from 300 to 1,200 holders of record;

- raising the limit for Regulation A offerings from $5 million to $50 million per year and exempting some Regulation A offerings from state blue sky laws;

- permitting advertising and general solicitation in Rule 506 and Rule 144A offerings;

- allowing private companies to use crowd funding to raise up to $1 million in any 12-month period, subject to certain conditions; and,

- creating a new category of issuer, called an Emerging Growth Company , for companies with less than $1 billion in annual gross revenue, which will benefit from certain changes that reduce the cost and burden of carrying out an equity initial public offering (IPO) and complying with public company reporting obligations for up to five years.

While the JOBS Act is not expected to have any immediate application to the Corporation, management will continue to monitor the implementation rules for potential effects which might benefit the Corporation.

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 are 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 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 these issuers.

*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 has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB, but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has 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 allows 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 (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). 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.

**SUPERVISION AND REGULATION**

*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.

*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.

**ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Management monitors and evaluates changes in market conditions on a regular basis. Based upon the most recent review, management has determined that there have been no material changes in market risks since year-end. For further discussion of year-end information, please refer to the Annual Report on Form 10-K for the fiscal year-ended December 31, 2011.

**ITEM 4 - CONTROLS AND PROCEDURES**

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, 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 its disclosure controls and procedures pursuant to Securities 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 the Corporation s periodic SEC filings.

Disclosure controls and procedures are Corporation controls and other procedures that are designed to ensure that information required to be disclosed by the Corporation in the reports that it files or submits under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms.

There were no changes in the Corporation s internal control over financial reporting during the fiscal quarter ended June 30, 2012, that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

## PART II - OTHER INFORMATION

**ACNB CORPORATION**

**ITEM 1 - LEGAL PROCEEDINGS**

As of June 30, 2012, 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 1A - RISK FACTORS**

Management has reviewed the risk factors that were previously disclosed in the Annual Report on Form 10-K for the fiscal year-ended December 31, 2011. There are no material changes from the risk factors as previously disclosed in the Form 10-K.

**ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On November 3, 2008, the Corporation announced a plan to purchase up to 120,000 shares of its outstanding common stock. There were no treasury shares purchased under this plan during the quarter ended June 30, 2012. The maximum number of shares that may yet be purchased under this stock repurchase plan is 57,400.

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 June 30, 2012, 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 June 30, 2012, there were no issued or outstanding shares of preferred stock.

**ITEM 3 - DEFAULTS UPON SENIOR SECURITIES -** NOTHING TO REPORT.

**ITEM 4 - MINE SAFETY DISCLOSURES -** NOT APPLICABLE.

**ITEM 5 - OTHER INFORMATION -** NOTHING TO REPORT.

**ITEM 6 - EXHIBITS**

The following exhibits are included in this report:

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| 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. (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.) |

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| 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, David L. Sites, 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.) |
| Exhibit 10.7 | Group Pension Plan for Employees of ACNB Bank. (Incorporated by reference to Exhibit 10.7 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the Commission on May 4, 2012.) |
| 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 10.14 | Salary Continuation Agreement by and between ACNB Bank and Thomas A. Ritter dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.) |
| Exhibit 10.15 | Salary Continuation Agreement by and between ACNB Bank and Lynda L. Glass dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.2 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.) |
| Exhibit 10.16 | Salary Continuation Agreement by and between ACNB Bank and David W. Cathell dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.3 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.) |
| Exhibit 10.17 | Amended and Restated 2001 Salary Continuation Agreement by and between ACNB Bank and Thomas A. Ritter dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.4 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.) |

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| Exhibit 10.18 | Amended and Restated 1996 Salary Continuation Agreement by and between ACNB Bank and Lynda L. Glass dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.5 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.) |
| Exhibit 11 | Statement re Computation of Earnings. (Incorporated by reference to page 7 of this Form 10-Q.) |
| 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 18 | Preferability letter from ParenteBeard LLC dated as of August 3, 2012. |
| Exhibit 31.1 | Chief Executive Officer Certification of Quarterly Report on Form 10-Q. |
| Exhibit 31.2 | Chief Financial Officer Certification of Quarterly Report on Form 10-Q. |
| 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. |

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| 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. |

**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)

Date: August 3, 2012

/s/ Thomas A. Ritter
Thomas A. Ritter
President & Chief Executive Officer

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