ACNB CORP
Form 10-Q
August 05, 2011

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, 2011

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 S No £

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes S No £

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

The number of shares of the Registrant s Common Stock outstanding on July 29, 2011, was 5,937,240.

PART I - FINANCIAL INFORMATION

ACNB CORPORATION

ITEM 1 - FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

Dollars in thousands, except per share data	June 30, 2011	June 30, 2010	December 31, 2010
ASSETS			
Cash and due from banks	**$ 13,382**	$ 14,193	$ 14,091
Interest bearing deposits with banks	**28,510**	14,807	10,082
Total Cash and Cash Equivalents	**41,892**	29,000	24,173
Securities available for sale	**207,719**	204,580	190,730
Securities held to maturity, fair value $10,702; $10,681; $10,671	**10,038**	10,051	10,044
Loans held for sale	**825**	3,662	3,068
Loans, net of allowance for loan losses $14,700; $14,344; $15,252	**653,652**	646,355	650,039
Premises and equipment	**14,418**	14,511	14,119
Restricted investment in bank stocks	**7,886**	9,170	8,420
Investment in bank-owned life insurance	**27,931**	26,699	27,443
Investments in low-income housing partnerships	**3,946**	4,245	4,124
Goodwill	**5,972**	5,972	5,972
Intangible assets	**3,369**	4,023	3,688
Foreclosed assets held for resale	**3,631**	7,395	7,859
Other assets	**17,058**	12,623	18,988
Total Assets	**$ 998,337**	$ 978,286	$ 968,667
LIABILITIES AND STOCKHOLDERS EQUITY			
LIABILITIES			
Deposits:			
Non-interest bearing	**$ 112,411**	$ 105,078	$ 103,464
Interest bearing	**656,989**	647,710	643,062
Total Deposits	**769,400**	752,788	746,526
Short-term borrowings	**47,924**	39,882	39,086
Long-term borrowings	**76,305**	83,725	81,499
Other liabilities	**7,375**	9,231	7,802
Total Liabilities	**901,004**	885,626	874,913
STOCKHOLDERS EQUITY			
Common stock, $2.50 par value; 20,000,000 shares authorized; 5,999,840, 5,990,943 and 5,990,943 shares issued; 5,937,240, 5,928,343 and 5,928,343 shares outstanding	**14,999**	14,977	14,977

Treasury stock, at cost (62,600 shares)		**(728)**		(728)		(728)
Additional paid-in capital		**8,901**		8,787		8,787
Retained earnings		**71,848**		67,857		69,536
Accumulated other comprehensive income		**2,313**		1,767		1,182
Total Stockholders Equity		**97,333**		92,660		93,754
Total Liabilities and Stockholders Equity	**$**	**998,337**	$	978,286	$	968,667

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, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
INTEREST INCOME				
Loans, including fees	**$ 8,605**	$ 9,476	**$ 17,228**	$ 18,271
Securities:				
Taxable	**1,550**	1,857	**3,081**	3,797
Tax-exempt	**304**	333	**608**	690
Dividends	**3**	8	**6**	15
Other	**26**	16	**45**	42
Total Interest Income	**10,488**	11,690	**20,968**	22,815
INTEREST EXPENSE				
Deposits	**1,111**	1,602	**2,247**	3,275
Short-term borrowings	**28**	31	**48**	73
Long-term borrowings	**755**	849	**1,515**	1,689
Total Interest Expense	**1,894**	2,482	**3,810**	5,037
Net Interest Income	**8,594**	9,208	**17,158**	17,778
PROVISION FOR LOAN LOSSES	**1,310**	2,351	**2,410**	3,210
Net Interest Income after Provision for Loan Losses	**7,284**	6,857	**14,748**	14,568
OTHER INCOME				
Service charges on deposit accounts	**603**	589	**1,166**	1,150
Income from fiduciary activities	**329**	326	**702**	603
Earnings on investment in bank-owned life insurance	**251**	260	**488**	507
Gain on life insurance proceeds		78		78
Net (losses) gains on sales of securities		(1)		25
Service charges on ATM and debit card transactions	**320**	290	**598**	544
Commissions from insurance sales	**1,308**	1,406	**2,513**	2,603
Other	**196**	212	**497**	518
Total Other Income	**3,007**	3,160	**5,964**	6,028
OTHER EXPENSES				
Salaries and employee benefits	**4,335**	4,327	**8,465**	8,495
Net occupancy	**500**	530	**1,056**	1,138
Equipment	**682**	605	**1,344**	1,231
Other tax	**175**	204	**383**	406
Professional services	**261**	236	**470**	481
Supplies and postage	**166**	177	**320**	345
Marketing	**128**	138	**252**	209
FDIC and regulatory	**335**	349	**740**	706
Intangible assets amortization	**160**	160	**321**	321

Other operating	**911**	764	**1,521**	1,630
Total Other Expenses	**7,653**	7,490	**14,872**	14,962
Income before Income Taxes	**2,638**	2,527	**5,840**	5,634
PROVISION FOR INCOME TAXES	**532**	462	**1,274**	1,147
Net Income	**$ 2,106**	$ 2,065	**$ 4,566**	$ 4,487
PER SHARE DATA				
Basic earnings	**$ 0.36**	$ 0.35	**$ 0.77**	$ 0.76
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 CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

Six Months Ended June 30, 2011 and 2010

Dollars in thousands	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
BALANCE JANUARY 1, 2010	$ 14,977	$ (728)	$ 8,787	$ 65,623	$ (356)	$ 88,303
Comprehensive income:						
Net income				4,487		4,487
Other comprehensive income, net of taxes					2,123	2,123
Total Comprehensive Income						6,610
Cash dividends declared				(2,253)		(2,253)
BALANCE JUNE 30, 2010	$ 14,977	$ (728)	$ 8,787	$ 67,857	$ 1,767	$ 92,660
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**

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, 2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 4,566**	$ 4,487
Adjustments to reconcile net income to net cash provided by operating activities:		
(Gain) loss on sales of loans and foreclosed real estate	**(284)**	6
Earnings on investment in bank-owned life insurance	**(488)**	(507)
Gain on life insurance proceeds		(78)
Gain on sales of securities		(25)
Depreciation and amortization	**1,135**	1,204
Provision for loan losses	**2,410**	3,210
Net amortization of investment securities premiums	**248**	15
Increase in interest receivable	**(125)**	(89)
Increase in interest payable	**53**	106
Mortgage loans originated for sale	**(10,770)**	(10,663)
Proceeds from loans sold to others	**13,212**	7,229
Decrease in other assets	**1,646**	400
Decrease in other liabilities	**(384)**	(113)
Net Cash Provided by Operating Activities	**11,219**	5,182
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of investment securities available for sale	**24,291**	26,783
Proceeds from sales of investment securities available for sale		3,697
Purchase of investment securities available for sale	**(39,902)**	(22,198)
Net increase in loans	**(7,490)**	(18,559)
Redemption of restricted investments in bank stocks	**534**	
Capital expenditures	**(1,113)**	(663)
Proceeds from life insurance death benefits		294
Proceeds from sale of foreclosed real estate	**5,780**	292
Net Cash Used in Investing Activities	**(17,900)**	(10,354)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits	**8,947**	11,249
Net increase in time certificates of deposits and interest bearing deposits	**13,927**	13,016
Net increase (decrease) in short-term borrowings	**8,838**	(15,409)
Dividends paid	**(2,254)**	(2,253)
Common stock issued	**136**	
Proceeds from long-term borrowings		19,000
Repayments on long-term borrowings	**(5,194)**	(15,569)
Net Cash Provided by Financing Activities	**24,400**	10,034
Net Increase in Cash and Cash Equivalents	**17,719**	4,862
CASH AND CASH EQUIVALENTS BEGINNING	**24,173**	24,138
CASH AND CASH EQUIVALENTS ENDING	**$ 41,892**	$ 29,000

Interest paid	**$**	**3,757**	$	4,931
Incomes taxes paid	**$**	**900**	$	1,500
Loans transferred to foreclosed real estate	**$**	**1,467**	$	1,700

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 locations in Adams, Cumberland and York Counties, Pennsylvania. There are also two loan production offices situated in York and Franklin Counties, Pennsylvania.

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

The Corporation, along with seven other banks, entered into a joint venture to form BankersRe Insurance Group, SPC (formerly Pennbanks Insurance Co., SPC), an offshore reinsurance company. Each participating entity owns an insurance cell through which its premiums and losses from credit life, health and accident insurance are funded. Each entity is responsible for the activity in its respective cell. The financial activity for the 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 as of June 30, 2011 and 2010, and the results of operations, changes in stockholders equity, and cash flows for the three and six months ended June 30, 2011 and 2010. 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 2010 ACNB Corporation Annual Report on Form 10-K, filed with the SEC on March 11, 2011. It is suggested that the consolidated financial statements contained herein be read in conjunction with the 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 period ended June 30, 2011, 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 balance sheet date of June 30, 2011, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

2. **Earnings Per Share**

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 5,931,962 and 5,928,343 weighted average shares of common stock outstanding for the six months ended June 30, 2011 and 2010, respectively, and 5,934,543 and 5,928,343 for the three months ended June 30, 2011 and 2010, respectively. The Corporation does not have dilutive securities outstanding.

3. **Retirement Benefits**

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

In thousands	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Service cost	**$ 143**	$ 115	**$ 286**	$ 230
Interest cost	**240**	268	**480**	536
Expected return on plan assets	**(457)**	(304)	**(914)**	(608)
Recognized net actuarial loss	**35**	109	**70**	218
Other, net	**13**	13	**26**	26
Net Periodic Benefit Cost (Income)	**$ (26)**	$ 201	**$ (52)**	$ 402

The Corporation previously disclosed in its consolidated financial statements for the year ended December 31, 2010, that it has not yet been determined the amount the Bank plans on contributing to the Plan in 2011. As of June 30, 2011, this contribution has still not been determined. The Corporation reduced the benefit formula for the defined benefit pension plan effective January 1, 2010, in order to manage total benefit costs. The new formula is the earned benefit as of December 31, 2009, plus 0.75% of a participant s average monthly pay multiplied by years of benefit service earned on and after January 1, 2010, but not more than 25 years. The benefit percentage factor and maximum years of service eligible were both reduced.

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 $6,089,000 in standby letters of credit as of June 30, 2011. 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, 2011, for guarantees under standby letters of credit issued is not material.

5. **Other Comprehensive Income**

The Corporation s other comprehensive income items are unrealized gains on securities available for sale and unfunded pension liability. The components of other comprehensive income for the three month and six month periods ended June 30 were as follows:

In thousands	Three Months Ended June 30, 2011		Three Months Ended June 30, 2010		Six Months Ended June 30, 2011		Six Months Ended June 30, 2010
Unrealized holding gains on available for sale securities arising during the period	**$**	**1,874**	$	1,905	**$**	**1,620**	$ 2,999
Reclassification of (gains) losses realized in net income				1			(25)
Net Unrealized Gains		**1,874**		1906		**1,620**	2,974
Tax effect		**637**		648		**551**	1,011
		1,237		1,258		**1,069**	1,963
Change in pension liability		**48**		122		**96**	244
Tax effect		**17**		42		**34**	84
		31		80		**62**	160
Other Comprehensive Income	**$**	**1,268**	$	1,338	**$**	**1,131**	$ 2,123

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

In thousands		Unrealized Gains on Securities		Pension Liability		Accumulated Other Comprehensive Income
BALANCE, JUNE 30, 2011	**$**	**4,992**	**$**	**(2,679)**	**$**	**2,313**
BALANCE, DECEMBER 31, 2010	$	3,923	$	(2,741)	$	1,182
BALANCE, JUNE 30, 2010	$	6,169	$	(4,402)	$	1,767

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. RIG offers a broad range of property and casualty, life and health insurance to both commercial and individual clients.

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Segment information for the six month periods ended June 30, 2011 and 2010, is as follows:

In thousands		**Banking**		**Insurance**		**Intercompany Eliminations**		**Total**
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**
2010								
Net interest income and other income from external customers	$	21,216	$	2,590	$		$	23,806
Income before income taxes		5,251		383				5,634
Total assets		968,704		12,630		(3,048)		978,286
Capital expenditures		647		16				663

Segment information for the three month periods ended June 30, 2011 and 2010, is as follows:

In thousands		**Banking**		**Insurance**		**Intercompany Eliminations**		**Total**
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**
2010								
Net interest income and other income from external customers	$	10,961	$	1,407	$		$	12,368
Income before income taxes		2,288		239				2,527
Total assets		968,704		12,630		(3,048)		978,286
Capital expenditures		209		6				215

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.

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, 2011, and December 31, 2010, were as follows:

In thousands		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
SECURITIES AVAILABLE FOR SALE								
JUNE 30, 2011								
U.S. Government and agencies	**$**	**43,131**	**$**	**490**	**$**	**50**	**$**	**43,571**
Mortgage-backed securities		**109,946**		**5,382**		**69**		**115,259**
State and municipal		**34,204**		**1,351**		**3**		**35,552**
Corporate bonds		**11,205**		**357**		**4**		**11,558**
CRA mutual fund		**1,044**		**11**				**1,055**
Stock in other banks		**626**		**98**				**724**
	$	**200,156**	**$**	**7,689**	**$**	**126**	**$**	**207,719**
DECEMBER 31, 2010								
U.S. Government and agencies	$	28,225	$	297	$	262	$	28,260
Mortgage-backed securities		109,386		5,292		319		114,359
State and municipal		34,214		643		181		34,676
Corporate bonds		11,303		367		11		11,659
CRA mutual fund		1,032				2		1,030
Stock in other banks		627		119				746
	$	184,787	$	6,718	$	775	$	190,730
SECURITIES HELD TO MATURITY								
JUNE 30, 2011								
U.S. Government and agencies	**$**	**10,038**	**$**	**664**	**$**		**$**	**10,702**
DECEMBER 31, 2010								
U.S. Government and agencies	$	10,044	$	627	$		$	10,671

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, 2011, six U.S. Government and agency securities 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 specific securities.

At June 30, 2011, five mortgage-backed securities had unrealized losses that individually did not exceed 1% 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, 2011, one state and municipal bond had an unrealized loss that individually did not exceed 1% of amortized cost. This security has not been in a continuous loss position for 12 months or more. This unrealized loss relates principally to changes in interest rates subsequent to the acquisition of specific securities.

At June 30, 2011, one corporate bond had an unrealized loss, which has not been in a continuous loss position for 12 months or more. The security in this category had an unrealized loss that did not exceed 1% of amortized cost. The unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the 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, 2011, management had not identified any securities with an unrealized loss that it intends or will be required to sell.

The following table shows the Corporation s investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2011, and December 31, 2010:

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, 2011						
U.S. Government and agencies	**$ 7,000**	**$ 50**	**$**	**$**	**$ 7,000**	**$ 50**
Mortgage-backed securities	**9,694**	**69**			**9,694**	**69**
State and municipal	**514**	**3**			**514**	**3**
Corporate bonds	**996**	**4**			**996**	**4**
	$ 18,204	**$ 126**	**$**	**$**	**$ 18,204**	**$ 126**

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
DECEMBER 31, 2010						
U.S. Government and agencies	$ 10,585	$ 262	$	$	$ 10,585	$ 262
Mortgage-backed securities	21,071	319			21,071	319
State and municipal	11,680	181			11,680	181
Corporate bonds	989	11			989	11
CRA mutual fund	1,030	2			1,030	2
	$ 45,355	$ 775	$	$	$ 45,355	$ 775

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Amortized cost and fair value at June 30, 2011, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

In thousands	Available for Sale Amortized Cost	Available for Sale Fair Value	Held to Maturity Amortized Cost	Held to Maturity Fair Value
1 year or less	$ 6,172	$ 6,334	$	$
Over 1 year through 5 years	32,431	33,183	10,038	10,702
Over 5 years through 10 years	40,087	41,094		
Over 10 years	9,850	10,070		
Mortgage-backed securities	109,946	115,259		
CRA mutual fund	1,044	1,055		
Stock in other banks	626	724		
	$ 200,156	$ 207,719	$ 10,038	$ 10,702

The Corporation did not realize any gross gains or losses during 2011 on sales of securities available for sale. The Corporation realized $75,000 of gross gains and $50,000 of gross losses during 2010 on sales of securities available for sale. State and municipal securities were sold at a loss in the second quarter of 2010 in order to adjust the Corporation s interest rate sensitivity, reduce exposure to geographical locations, and balance the mix with other investment types, and reduce risks related to insurance coverage.

At June 30, 2011, and December 31, 2010, securities with a carrying value of $102,061,000 and $99,197,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements, and for other purposes.

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 residential mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans (consisting of home equity lines of credit and consumer loan classes) are typically charged off no later than 120 days past due. Past due status is based on 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 allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, 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 loan, such as residential real estate, home equity, and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

- lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices;
- national, regional and local economic and business conditions, as well as the condition of various market segments, including the impact on the value of underlying collateral for collateral dependent loans;
- the nature and volume of the portfolio and terms of loans;
- the experience, ability and depth of lending management and staff;
- the volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

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

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

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

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

For commercial loans secured by real estate, estimated fair values of collateral are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal, and the condition of the property. Appraised values are discounted based on age of appraisal, special use nature of property, or condition of 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 restructurings 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 well documented credit evaluation of the borrower s financial condition there is reasonable assurance of repayment. Loans classified as troubled debt restructurings are generally designated as impaired.

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

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

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

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

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

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

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, etc.

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

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

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

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

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

Home equity lines of credit generally present 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 secured and unsecured consumer loans, including those for vehicles and mobile homes and loans secured by savings deposits. These loans originate primarily within the Corporation s market area or with customers primarily from the market area.

Consumer loan terms vary according to the type and value of collateral and the creditworthiness of the borrower. In underwriting consumer loans, a thorough analysis of the borrower s financial ability to repay the loan as agreed is performed. The ability to repay shall be determined by the borrower s employment history, current financial conditions, 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, 2011, and December 31, 2010:

IN THOUSANDS	Pass	Special Mention	Substandard	Doubtful	Total
June 30, 2011					
Commercial and industrial	**$ 50,246**	**$ 4,449**	**$ 4,203**	**$**	**$ 58,898**
Commercial real estate	**195,617**	**16,545**	**15,462**		**227,624**
Commercial real estate construction	**8,989**	**10,478**	**3,525**		**22,992**
Residential mortgage	**284,904**	**4,709**	**3,167**		**292,780**
Home equity lines of credit	**48,555**	**1,954**	**527**		**51,036**
Consumer	**15,022**				**15,022**
Total	**$ 603,333**	**$ 38,135**	**$ 26,884**	**$**	**$ 668,352**

IN THOUSANDS	Pass	Special Mention	Substandard	Doubtful	Total
December 30, 2011					
Commercial and industrial	$ 43,448	$ 5,041	$ 4,187	$	$ 52,676
Commercial real estate	193,731	14,530	17,689		225,950
Commercial real estate construction	11,009	10,963	4,663		26,635
Residential mortgage	289,833	2,882	4,282		296,997
Home equity lines of credit	46,383	2,081	393		48,857
Consumer	14,176				14,176
Total	$ 598,580	$ 35,497	$ 31,214	$	$ 665,291

The following table summarizes information in regards to impaired loans by loan portfolio class as of June 30, 2011, and December 31, 2010:

	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, 2011					
Commercial and industrial	$	$	$	**$ 338**	**$ 1,452**
Commercial real estate	**3,556**	**4,154**	**15**	**2,849**	**3,078**
Commercial real estate construction				**3,525**	**8,163**
Residential mortgage	**931**	**931**	**193**	**823**	**1,181**
TOTAL	**$ 4,487**	**$ 5,085**	**$ 208**	**$ 7,535**	**$ 13,874**

IN THOUSANDS	Impaired loans with allowance Recorded Investment	Impaired loans with allowance Unpaid Principal Balance	Impaired loans with allowance Related Allowance	Impaired loans with no allowance Recorded Investment	Impaired loans with no allowance Unpaid Principal Balance
DECEMBER 31, 2010					
Commercial and industrial	$ 869	$ 1,869	$ 547	$ 68	$ 68
Commercial real estate	4,326	4,326	726	3,955	4,184
Commercial real estate construction	4,216	7,716	729	172	232
Residential mortgage	97	97	57	954	1,312
TOTAL	$ 9,508	$ 14,008	$ 2,059	$ 5,149	$ 5,796

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

IN THOUSANDS	Three months ended June 30, 2011 Average Recorded Investment	Three months ended June 30, 2011 Interest Income	Six months ended June 30, 2011 Average Recorded Investment	Six months ended June 30, 2011 Interest Income
Commercial and industrial	$ 361	$	$ 410	$
Commercial real estate	7,182		7,706	44
Commercial real estate construction	3,706		3,933	
Residential mortgage	1,391		1,277	
TOTAL	$ 12,640	$	$ 13,326	$ 44

The following table presents nonaccrual loans by classes of the loan portfolio:

IN THOUSANDS	June 30, 2011	December 31, 2010
Commercial and industrial	**$ 338**	**$ 937**
Commercial real estate	**6,405**	**8,281**
Commercial real estate construction	**3,525**	**4,388**
Residential mortgage	**1,754**	**1,051**
Total	**$ 12,022**	**$ 14,657**

The following table summarizes information in regards to troubled debt restructurings:

In thousands	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
June 30, 2011		
Commercial and industrial	**$ 490**	**$ 319**
Commercial real estate	**$ 371**	**$ 153**
Commercial real estate construction	**$ 1,548**	**$ 1,262**

In thousands	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
December 31, 2010		
Commercial and industrial	$ 490	$ 439
Commercial real estate	$ 371	$ 168
Commercial real estate construction	$ 1,548	$ 1,536

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:

In thousands	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
June 30, 2011							
Commercial and industrial	**$ 49**	**$**	**$ 338**	**$ 387**	**$ 58,511**	**$ 58,898**	**$**
Commercial real estate	**856**	**429**	**6,405**	**7,690**	**219,934**	**227,624**	
Commercial real estate construction			**3,525**	**3,525**	**19,467**	**22,992**	
Residential mortgage	**534**	**1,005**	**3,073**	**4,612**	**288,168**	**292,780**	**1,319**
Home equity lines of credit	**127**		**178**	**305**	**50,731**	**51,036**	**178**
Consumer	**27**	**3**		**30**	**14,992**	**15,022**	
Total	**$ 1,593**	**$ 1,437**	**$ 13,519**	**$ 16,549**	**$ 651,803**	**$ 668,352**	**$ 1,497**

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

Allowance for loan losses and recorded investment in financing receivables:

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
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	**$ 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	**$ 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 Receivables								
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**

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
December 31, 2010								
Allowance for Loan Losses								
Ending balance	$ 2,074	$ 6,346	$ 1,154	$ 3,108	$ 341	$ 520	$ 1,709	$ 15,252
Ending balance: individually evaluated for impairment	$ 547	$ 726	$ 729	$ 57	$	$	$	$ 2,059
Ending balance: collectively evaluated for impairment	$ 1,527	$ 5,620	$ 425	$ 3,051	$ 341	$ 520	$ 1,709	$ 13,193

Loans Receivables								
Ending balance	$ 52,676	$ 225,950	$ 26,635	$ 296,997	$ 48,857	$ 14,176	$	$ 665,291
Ending balance: individually evaluated for impairment	$ 937	$ 8,281	$ 4,388	$ 1,051	$	$	$	$ 14,657
Ending balance: collectively evaluated for impairment	$ 51,739	$ 217,669	$ 22,247	$ 295,946	$ 48,857	$ 14,176	$	$ 650,634

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

9. Fair Value of Financial Instruments

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 period 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, 2011, and December 31, 2010, are as follows:

		Fair Value Measurements at June 30, 2011			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		$ **43,571**	$	$ **43,571**	$
Mortgage-backed securities		**115,259**		**115,259**	

State and municipal			**35,552**				**35,552**		
Corporate bonds			**11,558**				**11,558**		
CRA mutual fund			**1,055**		**1,055**				
Stock in other banks			**724**		**724**				
Total securities available for sale	**Recurring**	**$**	**207,719**	**$**	**1,779**	**$**	**205,940**	**$**	
Impaired loans	**Nonrecurring**	**$**	**4,279**	**$**		**$**		**$**	**4,279**
Foreclosed assets held for resale	**Nonrecurring**	**$**	**326**	**$**		**$**		**$**	**326**

In thousands	Basis	Fair Value Measurements at December 31, 2010 Total	Level 1	Level 2	Level 3
U.S. Government and agencies		$ 28,260	$	$ 28,260	$
Mortgage-backed securities		114,359		114,359	
State and municipal		34,676		34,676	
Corporate bonds		11,659		11,659	
CRA mutual fund		1,030	1,030		
Stock in other banks		746	746		
Total securities available for sale	Recurring	$ 190,730	$ 1,776	$ 188,954	$
Impaired loans	Nonrecurring	$ 7,449	$	$	$ 7,449
Foreclosed assets held for resale	Nonrecurring	$ 518	$	$	$ 518

The following table presents a reconciliation of impaired loans and foreclosed assets held for resale, measured at fair value, using significant unobservable inputs (Level 3), for the quarter ended June 30, 2011:

In thousands	Impaired Loans	Foreclosed Assets Held for Resale
Balance January 1, 2011	**$ 7,449**	**$ 518**
Settled or otherwise removed from impaired status	**(6,498)**	**(286)**
Additions to impaired status	**3,540**	
Charge-offs	**(1,879)**	
Payments made	**(88)**	
Decrease in valuation allowance	**1,851**	**94**
Loans transferred to foreclosed real estate	**(96)**	
Balance June 30, 2011	**$ 4, 279**	**$ 326**

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Corporation s financial instruments at June 30, 2011, and December 31, 2010:

Cash and Cash Equivalents (Carried at Cost)

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

Securities

The fair values of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or 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.

Foreclosed Assets Held for Resale

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

Restricted Investment in Bank Stock (Carried at Cost)

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

Accrued Interest Receivable and Payable (Carried at Cost)

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

Deposits (Carried at Cost)

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

Short-Term Borrowings (Carried at Cost)

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

Long-Term Borrowings (Carried at Cost)

Fair values of Federal Home Loan Bank (FHLB) advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, 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, 2011, and December 31, 2010, were as follows:

In thousands	June 30, 2011 Carrying Amount	June 30, 2011 Fair Value	December 31, 2010 Carrying Amount	December 31, 2010 Fair Value
Financial assets:				
Cash and due from banks	**$ 13,382**	**$ 13,382**	$ 14,091	$ 14,091
Interest bearing deposits in banks	**28,510**	**28,510**	10,082	10,082
Investment securities:				
Available for sale	**207,719**	**207,719**	190,730	190,730
Held to maturity	**10,038**	**10,702**	10,044	10,671
Loans held for sale	**825**	**825**	3,068	3,068
Loans, less allowance for loan losses	**653,652**	**670,351**	650,039	665,253
Accrued interest receivable	**3,542**	**3,542**	3,417	3,417
Restricted investment in bank stocks	**7,886**	**7,886**	8,420	8,420
Financial liabilities:				
Deposits	**769,400**	**772,767**	746,526	750,068
Short-term borrowings	**47,924**	**47,924**	39,086	39,086
Long-term borrowings	**76,305**	**80,697**	81,499	85,772
Accrued interest payable	**1,720**	**1,720**	1,667	1,667
Off-balance sheet financial instruments				

10. **New Accounting Pronouncements**

ASU 2011 - 02

The FASB has issued this ASU to clarify the accounting principles applied to loan modifications, as defined by FASB ASC Subtopic 310-40, *Receivables Troubled Debt Restructurings by Creditors*. This guidance was prompted by the increased volume in loan modifications prompted by the recent economic downturn. The ASU clarifies guidance on a creditor s evaluation of whether or not a concession has been granted, with an emphasis on evaluating all aspects of the modification rather than a focus on specific criteria, such as the effective interest rate test, to determine a concession. The ASU goes on to provide guidance on specific types of modifications such as changes in the interest rate of the borrowing, and insignificant delays in payments, as well as guidance on the creditor s evaluation of whether or not a debtor is experiencing financial difficulties.

For public entities, the amendments in the ASU are effective for the first interim or annual periods beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The entity should also disclose information required by ASU

2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*, which had previously been deferred by ASU 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in ASU No. 2010-20, for interim and annual periods beginning on or after June 15, 2011. Nonpublic entities are required to adopt the amendments in this ASU for annual periods ending on or after December 15, 2012. Early adoption is permitted.

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

ASU 2011 - 03

The FASB has issued this ASU to clarify the accounting principles applied to repurchase agreements, as set forth by FASB ASC Topic 860, *Transfers and Servicing*. This ASU, entitled Reconsideration of Effective Control for Repurchase Agreements, amends one of three criteria used to determine whether or not a transfer of assets may be treated as a sale by the transferor. Under Topic 860, the transferor may not maintain effective control over the transferred assets in order to qualify as a sale. This ASU eliminates the criteria under which the transferor must retain collateral sufficient to repurchase or redeem the collateral on substantially agreed upon terms as a method of maintaining effective control. This ASU is effective for both public and nonpublic entities for interim and annual reporting periods beginning on or after December 31, 2011, and requires prospective application to transactions or modifications of transactions which occur on or after the effective date. Early adoption is not permitted.

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

ASU 2011 04

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

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

ASU 2011 05

The provisions of this ASU amend FASB ASC Topic 220, *Comprehensive Income*, to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The ASU prohibits the presentation of the components of comprehensive income in the statement of stockholder s equity. Reporting entities are allowed to present either: a statement of comprehensive income, which reports both net income and other comprehensive income; or separate but consecutive statements of net income and other comprehensive income. Under previous GAAP, all 3 presentations were acceptable. Regardless of the presentation selected, the reporting entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. The provisions of this ASU are effective for fiscal years and interim periods beginning after December 31, 2011 for public entities. For nonpublic entities, the provisions are effective for fiscal years ending after December 31, 2012, and for interim and annual periods thereafter. As the two remaining options for presentation existed prior to the issuance of this ASU, early adoption is permitted.

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

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, 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 the 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 and expenses related to the charter conversion of our subsidiary bank from a federal to a state charter; 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 on its outstanding goodwill from its most recent testing, which was performed as of December 31, 2010. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested for impairment when such events occur. Other acquired intangible assets with finite lives, such as customer lists, are required to be amortized over the estimated lives. These intangibles are generally amortized using the straight line method over estimated useful lives of ten years.

RESULTS OF OPERATIONS

Quarter ended June 30, 2011, compared to quarter ended June 30, 2010

Executive Summary

Net income for the three months ended June 30, 2011, was $2,106,000 compared to $2,065,000 for the same quarter in 2010, an increase of $41,000 or 2%. Earnings per share was $0.36 in 2011 and $0.35 in 2010. Net interest income decreased $614,000 or 7% due in part to a large 2010 recovery of interest income associated with a commercial loan. Provision for loan losses decreased $1,041,000 or 44%; other income decreased $153,000 or 5%; and, other expenses increased $163,000 or 2%.

Net Interest Income

Net interest income totaled $8,594,000 for the quarter ended June 30, 2011, compared to $9,208,000 for the same period in 2010, a decrease of $614,000 or 7%. 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 $1,202,000 or 10% 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 not reinvested due to low market rates resulting from Federal Reserve buying activities. Finally, interest income was lower in the second quarter of 2011 compared the second quarter of 2010 due to a $605,000 (included in the $1,202,000 decrease above) interest recovery in 2010 on full payoff of a loan that was in nonaccrual status in prior years. Likewise, alternative funding sources, such as the 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 2011, 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 maintained it at 0% to

0.25% since that time. Interest expense decreased $588,000 or 24%. 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 dated December 31, 2010, and filed with the SEC on March 11, 2011. 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 2011 was 3.65% compared to 3.99% (3.72% without the one-time interest recovery) during the same period in 2010. Also comparing the second quarter of 2011 to 2010, the yield on interest earning assets decreased by 0.64% and the cost of interest bearing liabilities decreased by 0.30%. The net interest margin was 3.79% for the second quarter of 2011 and 4.16% (3.89% without the one-time interest recovery) for the second quarter of 2010. The net interest margin decline was mainly a result of the nonrecurring 2010 interest recovery and the rate of decline in the yield on assets decreasing to a greater degree than the decline in funding rates due to low rates on deposits as described above.

Average earning assets were $911,903,000 during the second quarter of 2011, an increase of $18,007,000 from the average for the second quarter of 2010. Average interest bearing liabilities were $774,731,000 in the second quarter of 2011, a decrease of $907,000 from the same quarter in 2010.

Provision for Loan Losses

The provision for loan losses was $1,310,000 in the second quarter of 2011 compared to $2,351,000 in the second quarter of 2010, a decrease of $1,041,000 or 44%. 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 second quarter of 2011, the Corporation had net charge-offs of $945,000, as compared to net charge-offs of $775,000 for the second quarter of 2010. In the second quarter of 2010, ACNB added a commercial loan general pool allowance consisting of participation loans, in part causing the higher provision expense in that quarter.

Other Income

Total other income was $3,007,000 for the three months ended June 30, 2011, down $153,000, or 5%, from the second quarter of 2010. Fees from deposit accounts increased by $14,000, or 2%, due to varying volume. Further, certain government regulations effective in 2010 limited service charge increases and make future revenue levels uncertain. Revenue from ATM and debit card transactions increased 10% to $320,000 due to higher volume. The increase resulted from consumer desire to use more electronic delivery channels; however, pending government regulations could result in price controls on this activity later in 2011 and future years, the effect of which cannot be currently quantified. Income from fiduciary activities, which include both institutional and personal trust management services, totaled $329,000 for the three months ended June 30, 2011, as compared to $326,000 during the second quarter of 2010, a 1% increase as a result of higher average assets under management. Earnings on bank-owned life insurance decreased by $9,000, or 3%, as a result of variations in crediting rates. Also, in 2010 the Corporation recorded a non-recurring gain on insurance proceeds. The Corporation s wholly-owned subsidiary, Russell Insurance Group, Inc. (RIG), saw revenue decrease by $98,000 or 7%. The decrease was due to generally lower recurring commissions in a soft insurance market and from the effects of the prolonged economic recession on business clients. Other income in the quarter ended June 30, 2011, was lower due to decreased fees related to sales of residential mortgages in 2011.

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 by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Goodwill, that has an indefinite useful life, and insurance books of business intangible assets, that are amortized over ten years, are evaluated for impairment annually and are evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired. That annual assessment date is December 31. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. The goodwill impairment analysis is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit s estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value 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, 2010 compared to 2009, commissions from insurance sales decreased 10% and, as some agency expenses are fixed, RIG s stand alone net income decreased by 39% in 2010 compared to 2009. Since the testing for potential impairment involves methods that include current and projected income amounts, the fair value declined at December 31, 2010, 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, 2010. 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 for contingent consideration owed on previous purchases of additional insurance books of business could also unfavorably impact the fair value of RIG. Although it is probable that some liability for further contingent consideration will be incurred, it is considered remote that the maximum aggregate liability of $1,800,000 will be incurred on the measurement dates. The amount of the ultimate liability is not reasonably estimable at June 30, 2011, because of the uncertainties in retaining books of business in the current economic cycle. Should it be determined in a future period that the goodwill has been impaired, then a charge to earnings will be recorded in the period such determination is made.

Other Expenses

The largest component of other expenses is salaries and employee benefits, which increased by $8,000, or less than 1%, when comparing the second quarter of 2011 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 increases to employees,
- An increase in the number of full-time equivalent employees,
- Increased payroll taxes including higher unemployment tax assessments, and

- Increased employee usage of medical insurance, 401(k) plan benefits and unused paid time off accumulation; all of which were partially offset by

- Decreased defined benefit pension expense resulting from a strong funded position in 2011.

Net occupancy expense decreased $30,000, or 6%, in part due reductions in overlapping physical locations and lower specific repair work. A new office in Spring Grove is scheduled to be opened in the second half of 2011. Equipment expense increased by $77,000, or 13%, as a result of equipment and software upgrades in order to keep electronic channels reliable and secure.

Professional services expense totaled $261,000 during the second quarter of 2011, as compared to $236,000 for the same period in 2010, an increase of $25,000 or 11%. The increase was due to higher loan collection legal costs.

Marketing expense decreased by $10,000, or 7% in the second quarter 2011, however year to date, marketing is higher in 2011. Higher marketing expense reflects higher current spending to promote certain in-market consumer loans. In addition the Corporation continued to advertise its products and services and to promote its brand via marketing communications.

FDIC expense for the second quarter of 2011 was $315,000, an increase of $20,000 from the second quarter of 2010. The increase was due in part to a higher deposit assessment base. Over the longer term, much higher expense is 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 Bank 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. As of 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 including quarter-end deposit levels and risk ratings.

Other tax expenses decreased by $29,000 or 14% due to a sales tax refund. Supplies and postage decreased $11,000 or 6% due to more electronic delivery. Other operating expenses increased by $147,000, or 19%, in the second quarter of 2011, as compared to the second quarter of 2010. Primarily responsible for the increase were writedowns and other expenses on foreclosed assets held for resale.

Income Tax Expense

The Corporation recognized income taxes of $532,000, or 20% of pretax income, during the second quarter of 2011, as compared to $462,000, or 18% of pretax income, during the same period in 2010. The variances from the federal statutory rate of 34% in both periods are generally due to tax-exempt income and investments in low-income housing partnerships (which qualify for federal tax credits). The income tax provision during the second quarters ended June 30, 2011 and 2010, included low-income housing tax credits of $139,000 and $145,000, respectively.

Six months ended June 30, 2011, compared to six months ended June 30, 2010

Executive Summary

Net income for the six months ended June 30, 2011, was $4,566,000 compared to $4,487,000 for the same period in 2010, an increase of $79,000 or 2%. Earnings per share was $0.77 in 2011 and $0.76 in 2010. Net interest income decreased $620,000 or 3%; provision for loan losses decreased $800,000 or 25%; other income decreased $64,000 or 1%; and, other expenses decreased $90,000 or 1%.

Net Interest Income

Net interest income totaled $17,158,000 for the six months ended June 30, 2011, compared to $17,778,000 for the same period in 2010, a decrease of $620,000 or 3%. Net interest income decreased due to a decrease in interest income to a greater degree than the decrease in interest expense both resulting from continued low rates maintained by the Federal Reserve Bank. Interest income decreased $1,847,000 or 8% 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 not reinvested due to low market rates resulting from Federal Reserve buying activities. Finally, interest income was lower in the second quarter of 2011 compared the second quarter of 2010 due to a $605,000 (included in the $1,847,000 decrease above) interest recovery in 2010 on full payoff of a loan that was in nonaccrual status in prior years. Likewise, alternative funding sources, such as the 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 2011, 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 maintained it at 0% to 0.25% since that time. Interest expense decreased $1,227,000 or 24%. 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 dated December 31, 2010, and filed with the SEC on March 11, 2011.

The net interest spread for the first six months of 2011 was 3.72% compared to 3.90% (3.76% without the one-time interest recovery) during the same period in 2010. Without the one-time interest recovery, the yield on interest earning assets decreased by 0.35%, primarily due to rates resetting and new loan origination at lower rates, and the cost of interest bearing liabilities decreased by 0.31%. The net interest margin was 3.87% for the first six months of 2011 and 4.07% (3.93% without the one-time interest recovery) for the first six months of 2010.

Average earning assets were $897,968,000 during the first six months of 2011, an increase of $11,016,000 from the average for the first six months of 2010. Average interest bearing liabilities were $766,647,000 in the first six months of 2011, a decrease of $5,811,000 from the same six months in 2010. However, average non interest-bearing demand deposits increased by $13,714,000 Access to funding in the local market that preferred dealing with a stable local institution was the primary reason for the in the increase in earning assets and local funding sources between the two periods.

Provision for Loan Losses

The provision for loan losses was $2,410,000 in the first six months of 2011, as compared to $3,210,000 in the first six months of 2010. The decrease was a result of measured risk in the loan portfolio compared with the balance in the allowance for loan losses. ACNB adjusts the provision for loan losses as necessary to maintain the allowance at a level deemed necessary to meet the risk characteristics of the loan portfolio. For more information, please refer to Allowance for Loan Losses in the subsequent Financial Condition section. For the first six months of 2011, the Corporation had net charge-offs of $2,962,000, as compared to net charge-offs of $847,000 for the first six months of 2010.

Other Income

Total other income was $5,964,000 for the six months ended June 30, 2011, down $64,000, or 1%, from the first six months of 2010. Fees from deposit accounts and were $1,166,000, an increase of $16,000, or 1%, due to increased volume. Certain government regulations effective in 2010 limited service charge increases and make future revenue levels uncertain. ATM/debit card revenue increased $54,000 or 10% as customers increasingly prefer electronic transactions; this revenue source is likewise subject to upcoming government regulation with the impact uncertain. Income from fiduciary activities, which include both institutional and personal trust management services, totaled $702,000 for the six months ended June 30, 2011, as compared to $603,000 during the first six months of 2010, a 16% increase as a result of higher average assets under management. Earnings on bank-owned life insurance decreased by $19,000, or 4%, on lower rates. A $78,000 gain on life insurance resulted from an insurance death claim for a Director in 2010. The Corporation s insurance subsidiary, Russell Insurance Group, Inc., experienced a revenue decrease of $90,000 or 3%. Revenue during the six month period was constrained by generally lower commissions in a soft insurance market and the effects of the prolonged economic recession on business clients. Contingent or extra commission payments from insurance carriers were stable with the previous year and are mostly received in the first quarter of each year; the amount is at the discretion of various insurance carriers in accordance with applicable insurance regulations. Gains on sales of securities decreased by $25,000 as securities were sold in 2010 to adjust the interest rate and credit risk position of the portfolio, no further action in this regard was taken in 2011. Other non-interest income was negatively impacted by decreased fees related to sales of residential mortgages, reflecting continued slow activity in this sector.

Other Expenses

The largest component of other expenses is salaries and employee benefits, which decreased by $30,000, or less than 1%, when comparing the first six months of 2011 to the same period a year ago. Overall, the decrease in salaries and employee benefits was the result of:

- Decreased defined benefit pension expense due to the reduced benefit formula implemented by the Corporation on January 1, 2010, offset by
- Varying employee usage of 401(k) plan benefits and unused paid time off accruals;
- Normal merit, production-based incentive and bonus compensation increases to employees;
- An increase in the number of full-time equivalent employees; and,
- Continued expensive medical insurance costs.

Net occupancy expense decreased by $82,000, or 7%, when comparing the first six months of 2011 to the same period a year ago due to lower specific repair costs between the two periods and the consolidation of overlapping office locations. Equipment expense increased by $113,000, or 9%, as a result of purchases and subsequent maintenance of new technology, communications and system reliability investments.

Professional services expense totaled $470,000 during the first six months of 2011, as compared to $481,000 for the same period in 2010, a decrease of $11,000 or 2%. The decrease was due to corporate governance expenditures in 2010.

Other tax expense decreased due to a refund of sales and use tax in 2011. Marketing expense increased by $43,000, or 21%, due to the promotion of consumer loans.

FDIC expense for the first six months of 2011 was $687,000, an increase of $89,000 from the same period in 2010. The higher expense in 2011 was in part a result of a higher deposit assessment base. Over the longer term, increased premiums were 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 the special assessment similar to which was levied on all insured banks in the second quarter of 2009. The prepaid assessments did not immediately affect bank earnings. ACNB recorded its prepaid assessments as a prepaid expense (an asset) as of December 30, 2009, the date the payment was made. As of 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 including quarter-end deposit levels and risk ratings.

Other operating expenses decreased $109,000, or 7%, in the first six months of 2011, as compared to the first six months of 2010. Increased costs include ongoing higher expenses to maintain foreclosed assets held for resale properties, which were offset by one time gains on certain sales primarily in the first quarter. In addition, decreased expense resulted from a new Internet Banking vendor and lower check clearing costs.

Income Tax Expense

The Corporation recognized income taxes of $1,274,000, or 22% of pretax income, during the first six months of 2011, as compared to $1,147,000, or 20% of pre-tax income, during the same period in 2010. The variances from the federal statutory rate of 34% in both periods are generally due to tax-exempt income on school district and bank qualified local government bonds and loans (on which the Corporation receives a lower yield), and investments in low-income housing partnerships (which qualify for federal tax credits). The effective tax rate was higher in 2011 than 2010 as income before income taxes increased while tax exempt income and tax credits decreased. The income tax provision during the six months ended June 30, 2011 and 2010, included historical and low-income housing tax credits of $278,000 and $289,000, respectively.

FINANCIAL CONDITION

Assets totaled $998,337,000 at June 30, 2011, compared to $968,667,000 at December 31, 2010, and $978,286,000 at June 30, 2010. Average earning assets during the six months ended June 30, 2011, increased to $897,968,000 from $886,952,000 during the same period in 2010. Average interest bearing liabilities decreased in 2011 to $766,647,000 from $772,458,000 in 2010 while average non interest-bearing deposits increased by $13,714,000.

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 balance sheet.

At June 30, 2011, the securities balance included a net unrealized gain of $4,992,000, net of taxes, on available for sale securities versus a net unrealized gain of $3,923,000, net of taxes, at December 31, 2010. The increase in fair value of securities during the first half 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. 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. 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 by 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 of Financial Instruments in the Notes to Consolidated Financial Statements for more information about fair value.

Loans

Loans outstanding increased by $7,653,000, or 1%, from June 30, 2010, to June 30, 2011, and increased by $3,061,000, or less than 1%, from December 31, 2010, to June 30, 2011. The lower than desired increase in loan volume in 2011 was in part due to charging-down loans against the allowance for loan losses, but in a broader sense, is a result of a continued sharp contraction in both commercial and consumer lending demand despite ACNB s continued resource allocation to facilitate lending in its marketplace. Compared to December 31, 2010, commercial loans (including loans to local government units) increased by approximately $6,000,000 or 12%. The commercial loan increase during this period was the result of competing for available loans even while reduced business activity in the market area hindered new originations. Commercial real estate loans (mostly owner occupied) increased by $2,000,000 or 1%, however real estate construction loans decreased by $4,000,000 or 14% as new housing development activity is very limited in the marketplace. Likewise, residential mortgages to consumers decreased by $4,000,000 or 1%. Most new originations of this product were sold into the secondary marketplace because of the low rate environment. Because of extensive marketing and retail staff efforts, home equity loans increased by $2,000,000 or 4% and other consumer loans increased by $1,000,000 or 6%. Management has limited new participation credits in conjunction with other financial institutions, due to potential credit risk. Participation loans at June 30, 2011, totaled approximately $26,000,000 compared to $25,000,000 at December 31, 2010. Residential mortgage loans secured by junior liens total approximately $28,000,000, 10% of total residential mortgage loans. Home equity loans are also in many cases junior liens and total approximately $51,000,000 at June 30, 2011. Although there is no material 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 has 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 the southcentral Pennsylvania and in the northern Maryland area that is contiguous to its Pennsylvania retail banking offices. This region currently and historically has lower unemployment than the U.S. as a whole. Included in commercial real estate loans are loans made to lessors of non-residential dwellings that total $96,875,000, or 14.5% of total loans, at June 30, 2011. These borrowers are geographically dispersed throughout ACNB s marketplace and are leasing commercial properties to a varied group of tenants including medical offices, retail space, and recreational facilities. Because of the varied nature 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 reflecting current conditions. 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 estimated 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 three years for each specific loan pool. Additionally, management adjusts projected loss ratios for other factors, including the following:

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

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

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

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

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

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

Management determines the unallocated portion, which represents the difference between the reported allowance for loan losses and the calculated allowance for loan losses, of the 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.

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, 2011, was $14,700,000, or 2.20% of loans, as compared to $14,344,000, or 2.17% of loans, at June 30, 2010, and $15,252,000, or 2.29% of loans, at December 31, 2010. The ratio of non-performing loans plus foreclosed assets to total assets was 1.72% at June 30, 2011, as compared to 2.09% at June 30, 2010, and 2.43% at December 31, 2010.

Changes in the allowance for loan losses were as follows:

In thousands	June 30, 2011	December 31, 2010	June 30, 2010
Beginning balance	**$ 15,252**	$ 11,981	$ 11,981
Provision charged to operations	**2,410**	6,410	3,210
Recoveries on charged-off loans	**19**	42	6
Loans charged-off	**(2,981)**	(3,181)	(853)
Ending balance	**$ 14,700**	$ 15,252	$ 14,344

Loans past due 90 days and still accruing were $1,497,000 and nonaccrual loans were $12,022,000 as of June 30, 2011. $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 $1,980,000 at June 30, 2010, while nonaccruals were $11,023,000. $2,000,000 of the nonaccrual balance and $373,000 of the 90 days and still accruing at June 30, 2010 were troubled debt restructured loans. Loans past due 90 days and still accruing were $997,000 at December 31, 2010, while nonaccruals were $14,657,000. $2,143,000 of the nonaccrual balance at December 31, 2010, were troubled debt restructured loans. Total additional loans classified as substandard (potential problem loans) at June 30, 2011, June 30, 2010 and December 31, 2010 were approximately $14,862,000, $16,517,000 and $15,560,000, respectively.

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, 2011 as compared to December 31, 2010 and 2009 is as follows:

IN THOUSANDS	Number of Credit Relationships	Balance	Specific Loss Allocations	Current Year Charge-Offs	Location	Originated
June 30, 2011						
Residential real estate developments	**5**	**$ 3,525**	**$ 0**	**$ 1,078**	**In market**	**2006 2010**
Owner occupied commercial real estate	**13**	**6,351**	**15**	**1,107**	**In market**	**1995 2008**
Investment/rental commercial real estate	**4**	**1,724**	**193**	**61**	**In market**	**2003 2007**
Commercial and industrial	**1**	**422**		**529**	**In market**	**2007**
Total	**23**	**$ 12,022**	**$ 208**	**$ 2,775**		
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.

IN THOUSANDS	Number of Credit Relationships	Balance	Specific Loss Allocations	Current Year Charge-Offs	Location	Originated
December 31, 2009						
Residential real estate developments	2	$ 5,419	$ 1,375	**$**	In market	2006
Economic development project	1	1,848	997		In market	2007
Owner occupied commercial real estate	7	3,267	43		In market	1998-2008
Investment/rental commercial real estate	3	1,584	857		In market	2004-2007
Commercial and industrial	2	1,190	675		In market	2007
Total	15	$ 13,308	$ 3,947	**$**		

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, 2011, the Corporation had two impaired loans to unrelated borrowers totaling $2,931,000 to finance residential real estate development projects in the Corporation s primary trading area of southcentral Pennsylvania, both of which are in nonaccrual of interest status. The loans have standard terms and conditions including repayment from the sales of the respective properties, and no interest reserves. Both loans were originated during the first half of 2006. One loan matured with the inability of the borrower to make the necessary infrastructure improvements.

The Corporation charged down the loan by $2.5 million in 2008 and entered into a forbearance agreement on which the borrower performed until 2010 and then filed bankruptcy. ACNB further wrote down the loan by $1,000,000 in 2010 and $804,000 in 2011 reflecting alternative uses on the property and updated information, respectively. It is expected that various real estate collateral on this loan will be protected by a fair value bid at sheriff sale later in 2011 after which ACNB will market the property to the appropriate buyers. On the other larger residential real estate loan, foreclosure has been held in abeyance while allowing the pursuit of a workout plan including providing additional collateral. Because of the length of time since the last sale, a $274,000 specific allocation was written down against the allowance for loan losses in 2011. Because of the 2011 write downs there is no specific valuation allowance on the two unrelated loans at June 30, 2011. 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 Bank s market area with standard terms and conditions and no interest reserves, but have suffered from the downturn in the real estate market. These loans total $594,000 with no specific allocation. The Bank will protect its interests by fair value bids at sheriff sale after which it will market the properties to the appropriate buyers if the loans are not brought current by the borrowers.

Owner occupied commercial real estate includes 13 loan relationships which total $6,351,000, one of which exceed $1,000,000 in outstanding balance. These loans were originated between 1995 and 2008. The largest loan in this category had a balance of $3,556,000 at June 30, 2011 after a partial charge-off of the $598,000 specific allocation was taken in the first quarter of 2011 due to uncertainty on when further legal collection actions could proceed. A charge off of $509,000 was taken on a former loan that has been transferred to foreclosed assets held for sale in the second quarter of 2011 in the amount of $511,000. The decrease in value was mainly caused by a protracted time period between default and when the Corporation was able to take control of the collateral because of legal actions of the borrower during which the property suffered significant deterioration. The other loans in this category are business loans impacted by the general economic downturn. Collection efforts will continue until it is deemed in the best interest to initiate foreclosure procedures. One loan had a specific loss allocation of $15,000.

Investment/rental commercial real estate includes four unrelated loan relationships totaling $1,724,000 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 2007, and were affected by the lack of borrower cash flow to continue to service the debt and in some cases by increased real estate taxes levied by local government units. The plan is to foreclose and subsequently market the real estate if ongoing workout efforts are not successful. One loan that became non-performing in the second quarter of 2011 has a balance of approximately $900,000 and a specific loss allocation totaling $193,000 based on the estimated fair value less cost to sell.

Included in impaired commercial and industrial loans 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 $422,000 at June 30, 2011 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 borrowers stated that no further payments are likely. 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.

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

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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 fair value of real estate acquired through foreclosure was $3,631,000 at June 30, 2011 compared to $7,859,000 at December 31, 2010. The decrease was mainly due to the full recovery on a commercial use property that had a fair value of $5,180,000, resulting in a $194,000 gain, and was collateral on a commercial loan in which the Corporation took a participation interest from another southcentral Pennsylvania bank. The largest addition in the second quarter of 2011 was the commercial real estate property mentioned above in the allowance for loan losses section that will be marketed to the appropriate industry after the property is stabilized. Other properties acquired in 2011 are actively being marketed. The Corporation expects to obtain and market additional foreclosed assets through the remainder of 2011, however the total amount and timing is currently not certain.

Deposits

ACNB continues to rely on deposits as a primary source of funds for lending activities with total deposits of $769,400,000 as of June 30, 2011. Deposits increased by $16,612,000, or 2%, from June 30, 2010, to June 30, 2011, and by $22,874,000, or 3%, from December 31, 2010, to June 30, 2011. 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 continue to improve, funds could leave the Corporation or be priced higher to maintain at similar levels.

Borrowings

Short-term borrowings are comprised primarily of securities sold under agreements to repurchase and demand notes to the U.S. Treasury. Investment securities are pledged in sufficient amounts to collateralize repurchase agreements. As of June 30, 2011, short-term borrowings were $47,924,000, as compared to $39,086,000 at December 31, 2010, and $39,882,000 at June 30, 2010. In comparison to year-end 2010 Short-term borrowings were up $8,838,000 due to seasonal fluctuations in the business activities of ACNB s commercial customer base. There were no short-term FHLB borrowings at the end of any of the periods. Long-term borrowings consist primarily of advances from the FHLB. Long-term borrowings totaled $76,305,000 at June 30, 2011, versus $81,499,000 at December 31, 2010, and $83,725,000 at June 30, 2010. The Corporation decreased long-term borrowings due to the lack of loan demand.

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 $97,333,000 at June 30, 2011, compared to $93,754,000 at December 31, 2010, and $92,660,000 at June 30, 2010. Stockholders equity increased in the first six months of 2011 by $3,579,000 due to $2,312,000 in earnings retained in capital and by an increase in accumulated other comprehensive income due to variation in the fair value of the investment portfolio. Other comprehensive income or loss is mainly caused by fixed-rate investment securities gaining or losing value in different interest rate environments and changes 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 2011, ACNB earned $4,566,000 and paid dividends of $2,254,000 for a dividend payout ratio of 49%. During the first six months of 2010, ACNB earned $4,487,000 and paid dividends of $2,253,000 for a dividend payout ratio of 50%.

On January 24, 2011, the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan was introduced for stockholders of record. This plan provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. As of June 30, 2011, 8,897 shares were issued under this plan with proceeds in the amount of $136,000. Proceeds will be used for general corporate purposes.

ACNB is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on ACNB. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, ACNB must meet specific capital guidelines that involve quantitative measures of 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, 2011 and December 31, 2010 that ACNB s banking subsidiary met all minimum capital adequacy requirements to which it is subject and is categorized as well capitalized . There are no conditions or events since the notification that management believes have changed the banking subsidiary s category.

Risk-Based Capital

The banking subsidiary s capital ratios are as follows:

	June 30, 2011	**December 31, 2010**	**To Be Well Capitalized Under Prompt Corrective Action Regulations**
Tier 1 leverage ratio (to average assets)	**8.31%**	8.24%	5.00%
Tier 1 risk-based capital ratio (to risk-weighted assets)	**12.29%**	11.99%	6.00%
Total risk-based capital ratio	**13.55%**	13.25%	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, 2011, ACNB s banking subsidiary had a borrowing capacity of approximately $293,968,000 from the FHLB, of which $219,968,000 was available. Since the second half of 2008, financial institutions have 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 recent 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, lower 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 $47,029,000 and $37,263,000 at June 30, 2011, and December 31, 2010, 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, 2011, the Corporation had unfunded outstanding commitments to extend credit of approximately $117,902,000 and outstanding standby letters of credit of approximately $6,089,000. 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

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

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 institutions. 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 records 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 31, 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. 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.

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

Holding Company Capital Requirements

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

Deposit Insurance

Dodd-Frank permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to $250,000 per depositor, and extends unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012. Dodd-Frank also broadens the base for FDIC insurance assessments. Assessments will now be 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, Dodd-Frank eliminates the federal statutory prohibition against the payment of interest on business checking accounts.

Corporate Governance

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

Prohibition Against Charter Conversions of Troubled Institutions

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

Interstate Branching

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

Limits on Interstate Acquisitions and Mergers

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

Limits on Interchange Fees

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

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, the Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act, and certain other statutes. The CFPB will have examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB, but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB will have authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower s ability to repay. In addition, Dodd-Frank will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a qualified mortgage as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

SMALL BUSINESS JOBS ACT - The Small Business Jobs Act was signed into law on September 27, 2010, which creates a $30 billion Small Business Lending Fund (Fund) to provide community banks with capital to increase small business lending. Generally, bank holding companies with assets equal to or less than $10 billion are eligible to apply for and receive a capital investment from the Fund in an amount equal to 3-5% of its risk-weighted assets.

The capital investment will take the form of preferred stock carrying a 5% dividend, which has the potential to decrease to as low as 1% if the participant sufficiently increases its small business lending within the first two and one-half years. If the participant does not increase its small business lending by at least 2.5% in the first two and one-half years, the dividend rate will increase to 7%. After four and one-half years, the dividend will increase to 9% regardless of the participant s small business lending. The deadline to apply to receive capital under the Fund is March 31, 2011. Whether the Fund will help spur the economy by increasing small business lending or strengthening the capital position of community banks is uncertain. ACNB has elected not to apply to receive capital under the Fund due to low loan demand and the uncertainties of a government program.

EMERGENCY ECONOMIC STABILIZATION ACT OF 2008 AND AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009 - In response to the financial crises affecting the banking system and financial markets and going concern threats to investment banks and other financial institutions, on October 3, 2008, the Emergency Economic Stabilization Act of 2008 (EESA) was signed into law and subsequently amended by the American Recovery and Reinvestment Act of 2009 on February 17, 2009. Under the authority of the EESA, as amended, the United States Department of the Treasury (Treasury) created the Troubled Asset Relief Program (TARP) Capital Purchase Program and through this program invested in financial institutions by purchasing preferred stock and warrants to purchase either common stock or additional shares of preferred stock. As of December 31, 2009, the Treasury will not make additional investments under the TARP Capital Purchase Program, but is considering continuing a similar program for banks under $10 billion in assets under a different program.

The EESA, as amended, also included a provision for a temporary increase in FDIC insurance coverage from $100,000 to $250,000 per depositor through December 31, 2009. In May 2009, Congress extended the increased coverage until December 31, 2013. After that time, the per depositor coverage will return to $100,000.

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

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

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

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

- Taking such stock or securities as collateral for loans.

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

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, 2010.

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 our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation s disclosure controls and procedures are effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in our periodic SEC filings.

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 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, 2011, that has materially affected, or is reasonably likely to materially affect, the internal controls over financial reporting.

PART II - OTHER INFORMATION

ACNB CORPORATION

ITEM 1 - LEGAL PROCEEDINGS

As of June 30, 2011, there were no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which ACNB or its subsidiaries are a party or by which any of their property is the subject. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation or its subsidiaries by governmental authorities.

ITEM 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, 2010. Other than the risk factor identified below, it was determined that there are no material changes from the risk factors as previously disclosed in the Form 10-K.

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

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

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, 2011. 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, 2011, there were no shares of common stock granted as restricted stock awards to either employees or directors.

On May 5, 2009, stockholders approved and adopted the amendment to the Articles of Incorporation of ACNB Corporation to authorize up to 20,000,000 shares of preferred stock, par value $2.50 per share. As of June 30, 2011, there were no issued or outstanding shares of preferred stock.

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

ITEM 4 - (REMOVED AND RESERVED).

ITEM 5 - OTHER INFORMATION - NOTHING TO REPORT.

ITEM 6 - EXHIBITS

The following exhibits are included in this report:

Exhibit 3(i)	Articles of Incorporation of ACNB Corporation, as amended. (Incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 2, 2009.)
Exhibit 3(ii)	Bylaws of ACNB Corporation, as amended. (Incorporated by reference to Exhibit 3.2 of the Registrant s Current Report on Form 8-K, filed with the Commission on March 22, 2010.)
Exhibit 10.1	ACNB Corporation, ACNB Acquisition Subsidiary LLC, and Russell Insurance Group, Inc. Stock Purchase Agreement. (Incorporated by reference to Exhibit 10.2 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
Exhibit 10.2	Salary Continuation Agreement - Applicable to Ronald L. Hankey, Thomas A. Ritter and Lynda L. Glass. (Incorporated by reference to Exhibit 10.2 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
Exhibit 10.3	Executive Supplemental Life Insurance Plan - Applicable to Ronald L. Hankey, Thomas A. Ritter, David W. Cathell and Lynda L. Glass. (Incorporated by reference to Exhibit 10.3 of the Registrant s Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the Commission on November 7, 2008.)
Exhibit 10.4	Director Supplemental Life Insurance Plan - Applicable to Frank Elsner III, James J. Lott, Robert W. Miller, Daniel W. Potts, Marian B. Schultz, David L. Sites, Alan J. Stock, Jennifer L. Weaver, Harry L. Wheeler and James E. Williams. (Incorporated by reference to Exhibit 10.5 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
Exhibit 10.5	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 November 27, 2007.)
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 Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Commission on March 12, 2010.)
Exhibit 10.8	Complete Settlement Agreement and General Release made among ACNB Corporation, Adams County National Bank and John W. Krichten effective June 13, 2006. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 15, 2006.)
Exhibit 10.9	Employment Agreement between ACNB Corporation, Adams County National Bank and Thomas A. Ritter dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.9 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)

Exhibit 10.10	Employment Agreement between ACNB Corporation, Adams County National Bank and Lynda L. Glass dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.10 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
Exhibit 10.11	Employment Agreement between ACNB Corporation, Russell Insurance Group, Inc. and Frank C. Russell, Jr. dated as of January 13, 2011. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on January 19, 2011.)
Exhibit 10.12	Employment Agreement between ACNB Corporation, Adams County National Bank and David W. Cathell dated as of April 17, 2009. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 23, 2009.)
Exhibit 10.13	2009 Restricted Stock Plan. (Incorporated by reference to Appendix C of the Registrant s Proxy Statement on Schedule 14A, filed with the Commission on March 25, 2009.)
Exhibit 11	Statement re Computation of Earnings. (Incorporated by reference to page 6 of this Form 10-Q.)
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.

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 5, 2011

/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)