

PLUMAS BANCORP
Form 10-K
March 23, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

**Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2011**

or

**Transaction report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission file number: 000-49883**

PLUMAS BANCORP

(Exact name of Registrant as specified in its charter)

California
(State or other jurisdiction of
incorporation or organization)

35 S. Lindan Avenue, Quincy, CA
(Address of principal executive offices)

75-2987096
(IRS Employer
Identification No.)

95971
(Zip Code)

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Registrant's telephone number, including area code: (530) 283-7305

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

Title of Each Class:	Name of Each Exchange on which Registered:
Common Stock, no par value	The NASDAQ Stock Market LLC

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

None.

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 <input type="checkbox"/>	Accelerated Filer <input type="checkbox"/>
Non-Accelerated Filer <input type="checkbox"/>	Smaller Reporting Company <input checked="" type="checkbox"/>

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

As of June 30, 2011, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant was approximately \$10.5 million, based on the closing price reported to the Registrant on that date of \$2.42 per share.

Shares of Common Stock held by each officer and director have been excluded in that such persons may be deemed to be affiliates. This determination of the affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares of Common Stock of the registrant outstanding as of March 22, 2012 was 4,776,339.

Documents Incorporated by Reference: Portions of the definitive proxy statement for the 2012 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission pursuant to SEC Regulation 14A are incorporated by reference in Part III, Items 10-14.

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PART I

Forward-Looking Information

This Annual Report on Form 10-K includes forward-looking statements and information is subject to the safe harbor provisions of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements (which involve Plumas Bancorp's (the Company's) plans, beliefs and goals, refer to estimates or use similar terms) involve certain risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the following factors:

Competitive pressure in the banking industry, competition in the markets the Company operates in and changes in the legal, accounting and regulatory environment

Changes in the interest rate environment and volatility of rate sensitive assets and liabilities

Declines in the health of the economy, nationally or regionally, which could reduce the demand for loans, reduce the ability of borrowers to repay loans and/or reduce the value of real estate collateral securing most of the Company's loans

Credit quality deterioration, which could cause an increase in the provision for loan and lease losses

Devaluation of fixed income securities

Asset/liability matching risks and liquidity risks

Loss of key personnel

Operational interruptions including data processing systems failure and fraud

The Company undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements.

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ITEM 1. BUSINESS

General

The Company. Plumas Bancorp (the *Company*) is a California corporation registered as a bank holding company under the *Bank Holding Company Act* of 1956, as amended, and is headquartered in Quincy, California. The Company was incorporated in January 2002 and acquired all of the outstanding shares of Plumas Bank (the *Bank*) in June 2002. The Company's principal subsidiary is the Bank, and the Company exists primarily for the purpose of holding the stock of the Bank and of such other subsidiaries it may acquire or establish. At the present time, the Company's only other subsidiaries are Plumas Statutory Trust I and Plumas Statutory Trust II, which were formed in 2002 and 2005 solely to facilitate the issuance of trust preferred securities.

The Company's principal source of income is dividends from the Bank, but the Company may explore supplemental sources of income in the future. The Bank cannot currently pay dividends without the prior approval of its primary regulators. The cash outlays of the Company, including (but not limited to) the payment of dividends to shareholders, if and when declared by the Board of Directors, costs of repurchasing Company common stock, the cost of servicing debt and preferred stock dividends, will generally be paid from dividends paid to the Company by the Bank. The Company cannot currently pay dividends without the prior approval of its primary regulators.

At December 31, 2011, the Company had consolidated assets of \$455 million, deposits of \$391 million, other liabilities of \$24 million and shareholders' equity of \$40 million. The Company's liabilities include \$10.3 million in junior subordinated deferrable interest debentures issued in conjunction with the trust preferred securities issued by Plumas Statutory Trust I (the *Trust I*) in September 2002 and Plumas Statutory Trust II (the *Trust II*) in September 2005. Both Trust I and Trust II are further discussed in the section titled *Trust Preferred Securities*. Shareholders' equity includes \$11.8 million in preferred stock issued pursuant to the U.S. government's Capital Purchase Program which is discussed in the section titled *Capital Purchase Program TARP Preferred Stock and Stock Warrant*.

References herein to the *Company*, *we*, *us* and *our* refer to Plumas Bancorp and its consolidated subsidiary, unless the context indicates otherwise. Our operations are conducted at 35 South Lindan Avenue, Quincy, California. Our annual, quarterly and other reports, required under the Securities Exchange Act of 1934 and filed with the Securities and Exchange Commission, (the *SEC*) are posted and are available at no cost on the Company's website, www.plumasbank.com, as soon as reasonably practicable after the Company files such documents with the SEC. These reports are also available through the SEC's website at www.sec.gov.

The Bank. The Bank is a California state-chartered bank that was incorporated in July 1980 and opened for business in December 1980. The Bank is not a member of the Federal Reserve System. The Bank's Administrative Office is located at 35 South Lindan Avenue, Quincy, California. At December 31, 2011 the Bank had approximately \$454 million in assets, \$287 million in net loans and \$392 million in deposits (including deposits of \$0.7 million from the Bancorp). It is currently the largest independent bank headquartered in Plumas County. The Bank's deposit accounts are insured by the Federal Deposit Insurance Corporation (the *FDIC*) up to maximum insurable amounts.

The Bank's primary service area covers the Northeastern portion of California, with Lake Tahoe to the South and the Oregon border to the North. The Bank, through its eleven branch network, serves the seven contiguous California counties of Plumas, Nevada, Sierra, Placer, Lassen, Modoc and Shasta. The branches are located in the communities of Quincy, Portola, Greenville, Truckee, Fall River Mills, Alturas, Susanville, Chester, Tahoe City, Kings Beach and Redding. The Bank maintains fifteen automated teller machines (*ATMs*) tied in with major statewide and national networks. In addition to its branch network, the Bank operates a lending office specializing in government-guaranteed lending in Auburn, California. The Bank's primary business is servicing the banking needs of these communities. Its marketing strategy stresses its local ownership and commitment to serve the banking needs of individuals living and working in the Bank's primary service areas.

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With a predominant focus on personal service, the Bank has positioned itself as a multi-community independent bank serving the financial needs of individuals and businesses within the Bank's geographic footprint. Our principal retail lending services include consumer, automobile and home equity loans. Our principal commercial lending services include term real estate, commercial and industrial term loans. In addition, we provide government-guaranteed and agricultural loans as well as credit lines. We provide land development and construction loans on a limited basis.

The Bank's Government-guaranteed lending center, headquartered in Auburn, California with additional personnel in Truckee, provides Small Business Administration and USDA Rural Development loans to qualified borrowers throughout Northern California and Northern Nevada. During 2007 the Bank was granted nationwide Preferred Lender status with the U.S. Small Business Administration and we expect government-guaranteed lending to continue to be an important part of our overall lending operation. During 2010 proceeds from the sale of government-guaranteed loans totaled \$14.9 million and we generated a gain on sale of \$1.1 million. In 2011 proceeds from the sale of government guaranteed loans totaled \$23.4 million and we generated a gain on sale of \$1.9 million.

The Agricultural Credit Centers located in Susanville and Alturas provide a complete line of credit services in support of the agricultural activities which are key to the continued economic development of the communities we serve. Ag lending clients include a full range of individual farming customers, small- to medium-sized business farming organizations and corporate farming units.

As of December 31, 2011, the principal areas to which we directed our lending activities, and the percentage of our total loan portfolio comprised by each, were as follows: (i) commercial real estate 40.6%; (ii) commercial and industrial loans 10.3%; (iii) consumer loans (including residential equity lines of credit) 16.8%; (iv) agricultural loans (including agricultural real estate loans) 13.2%; (v) residential real estate 13.3%; and (vi) construction and land development 5.8% .

In addition to the lending activities noted above, we offer a wide range of deposit products for the retail and commercial banking markets including checking, interest-bearing checking, business sweep, public funds sweep, savings, time deposit and retirement accounts, as well as remote deposit, telephone and mobile banking and internet banking with bill-pay options. Interest bearing deposits include high yield sweep accounts designed for our commercial customers and for public entities such as municipalities. In addition we offer a premium interest bearing checking account for our consumer customers. As of December 31, 2011, the Bank had 29,359 deposit accounts with balances totaling approximately \$392 million, compared to 30,372 deposit accounts with balances totaling approximately \$425 million at December 31, 2010. We attract deposits through our customer-oriented product mix, competitive pricing, convenient locations, extended hours, remote deposit operations and drive-up banking, all provided with a high level of customer service.

Most of our deposits are attracted from individuals, business-related sources and smaller municipal entities. This mix of deposit customers resulted in a relatively modest average deposit balance of approximately \$13,000 at December 31, 2011. However, it makes us less vulnerable to adverse effects from the loss of depositors who may be seeking higher yields in other markets or who may otherwise draw down balances for cash needs.

We also offer a variety of other products and services to complement the lending and deposit services previously reviewed. These include cashier's checks, bank-by-mail, ATMs, night depository, safe deposit boxes, direct deposit, electronic funds transfers, on-line banking, remote deposit, mobile banking and other customary banking services.

In order to provide non-deposit investment options, we have developed a strategic alliance with Financial Network Investment Corporation (FNIC). Through this arrangement, certain employees of the Bank are also licensed representatives of FNIC. These employees provide our customers throughout our branch network with convenient access to annuities, insurance products, mutual funds, and a full range of investment products.

Through our offering of a Remote Deposit product our customers are able to make non-cash deposits remotely from their physical location. With this product, we have extended our service area and can now meet the deposit needs of customers who may not be located within a convenient distance of one of our branch offices.

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Additionally, the Bank has devoted a substantial amount of time and capital to the improvement of existing Bank services, during 2009 we replaced our on-line banking service with a new state of the art product that greatly expands the features available to our customers. In addition we utilized this platform to add mobile banking services during the first quarter of 2010. During 2010 Plumas Bank began offering a new Green Account which promotes protecting the environment, reducing clutter and making life simpler for the customer through technological advancements such as eStatements, online banking, and debit card usage while providing the customer with the opportunity to grow their savings through monthly monetary rewards for green behavior. In 2011, we introduced a new product for our larger business customers which use repurchase agreements as an alternative to interest-bearing deposits. The balance in this product at December 31, 2011 was \$8.3 million. Interest paid on this product is similar to that which can be earned on the Bank's premium money market account; however, these are not deposits and are not FDIC insured. During the first quarter of 2012 we replaced our ATMs with new state of the art machines that are capable of accepting check and cash deposits without a deposit envelope.

The officers and employees of the Bank are continually engaged in marketing activities, including the evaluation and development of new products and services, to enable the Bank to retain and improve its competitive position in its service area.

We hold no patents or licenses (other than licenses required by appropriate bank regulatory agencies or local governments), franchises, or concessions. Our business has a modest seasonal component due to the heavy agricultural and tourism orientation of some of the communities we serve. As our branches in less rural areas such as Truckee have expanded and with the opening of our Auburn commercial lending office, the agriculture-related base has become less significant. We are not dependent on a single customer or group of related customers for a material portion of our deposits, nor are a material portion of our loans concentrated within a single industry or group of related industries. There has been no material effect upon our capital expenditures, earnings, or competitive position as a result of federal, state, or local environmental regulation.

Commitment to our Communities. The Board of Directors and Management believe that the Company plays an important role in the economic well being of the communities it serves. Our Bank has a continuing responsibility to provide a wide range of lending and deposit services to both individuals and businesses. These services are tailored to meet the needs of the communities served by the Company and the Bank.

We offer various loan products which promote home ownership and affordable housing, encourage job growth and support community economic development. Types of loans offered range from personal and commercial loans to real estate, construction, agricultural, and government-guaranteed community infrastructure loans. Many banking decisions are made locally with the goal of maintaining customer satisfaction through the timely delivery of high quality products and services.

Capital Purchase Program TARP Preferred Stock and Stock Warrant. On January 30, 2009 the Company entered into a Letter Agreement (the Purchase Agreement) with the United States Department of the Treasury (Treasury), pursuant to which the Company issued and sold (i) 11,949 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Series A Preferred Stock) and (ii) a warrant (the Warrant) to purchase 237,712 shares of the Company's common stock, no par value (the Common Stock), for an aggregate purchase price of \$11,949,000 in cash.

The Series A Preferred Stock qualifies as Tier 1 capital and pays cumulative dividends quarterly at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Company may redeem the Series A Preferred Stock at its liquidation preference (\$1,000 per share) plus accrued and unpaid dividends under the American Recovery and Reinvestment Act of 2009, subject to the Treasury's consultation with the Company's appropriate federal regulator.

The Warrant has a 10-year term and was immediately exercisable with an exercise price, subject to antidilution adjustments, equal to \$7.54 per share of the Common Stock. Treasury has agreed not to exercise voting power with respect to any shares of Common Stock issued upon exercise of the Warrant.

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Prior to January 30, 2012, unless the Company has redeemed the Series A Preferred Stock, or the Treasury has transferred the Series A Preferred Stock to a third party, the consent of the Treasury will be required for the Company to: (1) declare or pay any dividend or make any distribution on shares of the Common Stock (other than regular quarterly cash dividends of not more than \$0.04 per share or regular semi-annual cash dividends of not more than \$0.08 per share); or (2) redeem, purchase or acquire any shares of Common Stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the Purchase Agreement. At the request of the Federal Reserve Bank of San Francisco (FRB), Plumas Bancorp suspended quarterly cash dividend payments on its Series A Preferred Stock. As of December 31, 2011 the amount of the arrearage on the dividend payments of the Series A Preferred Stock is \$1,046,000 representing seven quarterly payments.

Trust Preferred Securities. During the third quarter of 2002, the Company formed a wholly owned Connecticut statutory business trust, Plumas Statutory Trust I (the Trust I). On September 26, 2002, the Company issued to the Trust I, Floating Rate Junior Subordinated Deferrable Interest Debentures due 2032 (the Debentures) in the aggregate principal amount of \$6,186,000. In exchange for these debentures the Trust I paid the Company \$6,186,000. The Trust I funded its purchase of debentures by issuing \$6,000,000 in floating rate capital securities (trust preferred securities), which were sold to a third party. These trust preferred securities qualify as Tier I capital under current Federal Reserve Board guidelines. The Debentures are the only asset of the Trust I. The interest rate and terms on both instruments are substantially the same. The rate is based on the three-month LIBOR (London Interbank Offered Rate) plus 3.40%, not to exceed 11.9%, adjustable quarterly. The proceeds from the sale of the Debentures were primarily used by the Company to inject capital into the Bank.

During the third quarter of 2005, the Company formed a wholly owned Connecticut statutory business trust, Plumas Statutory Trust II (the Trust II). On September 28, 2005, the Company issued to the Trust II, Floating Rate Junior Subordinated Deferrable Interest Debentures due 2035 (the Debentures) in the aggregate principal amount of \$4,124,000. In exchange for these debentures the Trust II paid the Company \$4,124,000. The Trust II funded its purchase of debentures by issuing \$4,000,000 in floating rate capital securities (trust preferred securities), which were sold to a third party. These trust preferred securities qualify as Tier I capital under current Federal Reserve Board guidelines. The Debentures are the only asset of the Trust II. The interest rate and terms on both instruments are substantially the same. The rate is based on the three-month LIBOR (London Interbank Offered Rate) plus 1.48%, adjustable quarterly. The proceeds from the sale of the Debentures were primarily used by the Company to inject capital into the Bank.

The Debentures and trust preferred securities accrue and pay distributions quarterly based on the floating rate described above on the stated liquidation value of \$1,000 per security. The Company has entered into contractual agreements which, taken collectively, fully and unconditionally guarantee payment of: (1) accrued and unpaid distributions required to be paid on the capital securities; (2) the redemption price with respect to any capital securities called for redemption by either Trust I or Trust II, and (3) payments due upon voluntary or involuntary dissolution, winding up, or liquidation of either Trust I or Trust II.

The trust preferred securities are mandatorily redeemable upon maturity of the Debentures on September 26, 2032 for Trust I and September 28, 2035 for Trust II, or upon earlier redemption as provided in the indenture.

Neither Trust I nor Trust II are consolidated into the Company's consolidated financial statements and, accordingly, both entities are accounted for under the equity method and the junior subordinated debentures are reflected as debt on the consolidated balance sheet. At the request of the FRB, Plumas Bancorp deferred its regularly scheduled quarterly interest payments on its outstanding junior subordinated debentures relating to its two trust preferred securities. As of December 31, 2011 the amount of the arrearage on the payments on the subordinated debt associated with the trust preferred securities is \$569,000 representing seven quarterly payments.

Recent Developments. Effective in March, 2011, in connection with the Bank's regularly scheduled 2010 Joint FDIC and California Department of Financial Institutions (DFI) examination, the Bank entered into a Consent Order (Order) with the FDIC and the DFI. The FDIC and DFI in the Order, required certain actions to be taken by the Bank including among others: continue to reduce certain classified asset balances, maintain strong capital ratios, improve lending policies and practices, and retain qualified management as stated in the terms of the Order. On February 15, 2012 the FDIC and DFI terminated this Order. While the Bank is no longer subject to an Order, the Bank has entered into an informal agreement with the FDIC and DFI which, among other things, requests that the Bank continue to maintain a Tier 1 Leverage Capital Ratio of 9% which is in excess of that required for well capitalized institutions and continue to reduce its level of classified asset balances that were outstanding as of September 30, 2011 to not more than 50% of Tier 1 Capital plus the allowance for loan losses. At December 31, 2011 this ratio was 68% and the Bank's Tier 1 Leverage Capital Ratio was 9.8%.

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The lifting of the Order reflects the progress made by the Bank's management and board of directors in reducing classified asset balances, increasing capital ratios, improving lending policies and practices, and retaining qualified management as stated in the terms of the Order.

On July 28, 2011 the Company entered into an agreement with the Federal Reserve Bank of San Francisco (the "FRB Agreement"). Under the terms of the FRB Agreement, Plumas Bancorp has agreed to take certain actions that are designed to maintain its financial soundness so that it may continue to serve as a source of strength to the Bank. Among other things, the FRB Agreement requires prior written approval related to the payment or taking of dividends and distributions, making any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities, incurrence of debt, and the purchase or redemption of stock. In addition, the FRB Agreement requires Plumas Bancorp to submit, within 60 days of the FRB Agreement, a written statement of Plumas Bancorp's planned sources and uses of cash for debt service, operating expense and other purposes ("Cash Flow Statement") for the remainder of 2011 and annually thereafter. The Company submitted the Cash Flow Statements within the required time frames.

See Note 2 "Regulatory Matters" of the Company's Consolidated Financial Statements in Item 8 "Financial Statements and Supplementary Data" of this Annual Report on Form 10K for additional information related to the Order and FRB Agreement.

Business Concentrations. No individual or single group of related customer accounts is considered material in relation to the Bank's assets or deposits, or in relation to our overall business. However, at December 31, 2011 approximately 81% of the Bank's total loan portfolio consisted of real estate-secured loans, including real estate mortgage loans, real estate construction loans, consumer equity lines of credit, and agricultural loans secured by real estate. Moreover, our business activities are currently focused in the California counties of Plumas, Nevada, Placer, Lassen, Modoc, Shasta and Sierra and Washoe County in Nevada. Consequently, our results of operations and financial condition are dependent upon the general trends in these economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of our operations in these areas of California and Nevada exposes us to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in these regions in California and Nevada.

Competition. With respect to commercial bank competitors, the business is largely dominated by a relatively small number of major banks with many offices operating over a wide geographical area. These banks have, among other advantages, the ability to finance wide-ranging and effective advertising campaigns and to allocate their resources to regions of highest yield and demand. Many of the major banks operating in the area offer certain services that we do not offer directly but may offer indirectly through correspondent institutions. By virtue of their greater total capitalization, such banks also have substantially higher lending limits than we do. For customers whose loan demands exceed our legal lending limit, we attempt to arrange for such loans on a participation basis with correspondent or other banks.

In addition to other banks, our competitors include savings institutions, credit unions, and numerous non-banking institutions such as finance companies, leasing companies, insurance companies, brokerage firms, and investment banking firms. In recent years, increased competition has also developed from specialized finance and non-finance companies that offer wholesale finance, credit card, and other consumer finance services, including on-line banking services and personal financial software. Strong competition for deposit and loan products affects the rates of those products as well as the terms on which they are offered to customers. Mergers between financial institutions have placed additional competitive pressure on banks within the industry to streamline their operations, reduce expenses, and increase revenues. Competition has also intensified due to federal and state interstate banking laws enacted in the mid-1990's, which permit banking organizations to expand into other states. The relatively large California market has been particularly attractive to out-of-state institutions. The Financial Modernization Act, which became effective March 11, 2000, has made it possible for full affiliations to occur between banks and securities firms, insurance companies, and other financial companies, and has also intensified competitive conditions.

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Currently, within the Bank's branch service area there are 55 banking branch offices of competing institutions, including 30 branches of 8 major banks. As of June 30, 2011, the Federal Deposit Insurance Corporation (FDIC) estimated the Bank's market share of insured deposits within the communities it serves to be as follows: Chester 68%, Quincy 59%, Portola 55%, Alturas 47%, Fall River Mills 36%, Susanville 33%, Kings Beach 32%, Truckee 15%, Tahoe City 5%, Redding less than 1% and 100% in Greenville. Redding is the location of our most recently opened branch, which became operational in June 2007.

Technological innovations have also resulted in increased competition in financial services markets. Such innovation has, for example, made it possible for non-depository institutions to offer customers automated transfer payment services that previously were considered traditional banking products. In addition, many customers now expect a choice of delivery systems and channels, including telephone, mail, home computer, mobile, ATMs, full-service branches, and/or in-store branches. The sources of competition in such products include traditional banks as well as savings associations, credit unions, brokerage firms, money market and other mutual funds, asset management groups, finance and insurance companies, internet-only financial intermediaries, and mortgage banking firms.

For many years we have countered rising competition by providing our own style of community-oriented, personalized service. We rely on local promotional activity, personal contacts by our officers, directors, employees, and shareholders, automated 24-hour banking, and the individualized service that we can provide through our flexible policies. This approach appears to be well-received by our customers who appreciate a more personal and customer-oriented environment in which to conduct their financial transactions. To meet the needs of customers who prefer to bank electronically, we offer telephone banking, mobile banking, remote deposit, and personal computer and internet banking with bill payment capabilities. This high tech and high touch approach allows the customers to tailor their access to our services based on their particular preference.

Employees. At December 31, 2011, the Company and its subsidiary employed 156 persons. On a full-time equivalent basis, we employed 142 persons. None of the Company's employees are represented by a labor union, and management considers its relations with employees to be good.

Code of Ethics. The Board of Directors has adopted a code of business conduct and ethics for directors, officers (including Plumas Bancorp's principal executive officer and principal financial officer) and financial personnel, known as the Corporate Governance Code of Ethics. This Code of Ethics Policy is available on Plumas Bancorp's website at www.plumasbank.com. Shareholders may request a free copy of the Code of Ethics Policy from Plumas Bancorp, Ms. Elizabeth Kuipers, Investor Relations, 35 S. Lindan Avenue, Quincy, California 95971.

Supervision and Regulation

General. We are extensively regulated under federal and state law. These laws and regulations are generally intended to protect depositors and customers, not shareholders. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statute or regulation. Any change in applicable laws or regulations may have a material effect on our business and prospects. Our operations may be affected by legislative changes and by the policies of various regulatory authorities. We cannot accurately predict the nature or the extent of the effects on our business and earnings that fiscal or monetary policies, or new federal or state legislation may have in the future. The Company is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, both as administered by the Securities and Exchange Commission. As a listed company on NASDAQ, the Company is subject to NASDAQ rules for listed companies.

Holding Company Regulation. We are a registered bank holding company under the Bank Holding Company Act, and are subject to the supervision of, and regulation by, the Board of Governors of the Federal Reserve System (the "Federal Reserve"). As a bank holding company, we are examined by and file reports with the Federal Reserve. The Federal Reserve expects a bank holding company to serve as a source of financial and managerial strength to its subsidiary bank and, under appropriate circumstances, to commit resources to support the subsidiary bank.

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Federal and State Bank Regulation. The Bank, as a state chartered bank with deposits insured by the FDIC, is primarily subject to the supervision and regulation of the California Department of Financial Institutions, the FDIC, and the Consumer Financial Protection Bureau (CFPB). These agencies may prohibit the Bank from engaging in what they believe constitute unsafe or unsound banking practices. The California Department of Financial Institutions regularly examines the Bank or participates in joint examinations with the FDIC.

The Community Reinvestment Act (CRA) requires that, in connection with examinations of financial institutions within its jurisdiction, the FDIC evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or new facility. A less than Satisfactory rating would result in the suspension of any growth of the Bank through acquisitions or opening de novo branches until the rating is improved. As of the most recent CRA examination the Bank's CRA rating was Satisfactory.

Banks are also subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to executive officers, directors, principal shareholders or any related interest of such persons. Extensions of credit must be made on substantially the same terms, including interest rates and collateral as, and follow credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions with persons not affiliated with the bank, and must not involve more than the normal risk of repayment or present other unfavorable features. Banks are also subject to certain lending limits and restrictions on overdrafts to such persons. A violation of these restrictions may result in the assessment of substantial civil monetary penalties on the affected bank or any officer, director, employee, agent or other person participating in the conduct of the affairs of that bank, the imposition of a cease and desist order, and other regulatory sanctions.

The Federal Reserve Act and related Regulation W limit the amount of certain loan and investment transactions between the Bank and its affiliates, require certain levels of collateral for such loans, and limit the amount of advances to third parties that may be collateralized by the securities of the Company or its subsidiaries. Regulation W requires that certain transactions between the Bank and its affiliates be on terms substantially the same, or at least as favorable to the Bank, as those prevailing at the time for comparable transactions with or involving nonaffiliated companies or, in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to or would apply to nonaffiliated companies. The Company and its subsidiaries have adopted an Affiliate Transactions Policy and have entered into various affiliate agreements in compliance with Regulation W.

The Federal Reserve and the FDIC have adopted non-capital safety and soundness standards for institutions. These standards cover internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, and standards for asset quality, earnings and stock valuation. An institution that fails to meet these standards must develop a plan acceptable to the agency, specifying the steps that it will take to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. We believe that the Bank is in compliance with these standards.

Federal Deposit Insurance. Substantially all deposits with the Bank are insured up to applicable limits by the Deposit Insurance Fund (DIF) of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The FDIC uses a risk-based assessment system that imposes insurance premiums based upon a bank's capital level and supervisory ratings. The base assessment rates under the Federal Deposit Insurance Reform Act of 2005 (Reform Act), enacted in February 2006, ranged from \$0.02 to \$0.40 per \$100 of deposits annually. The FDIC could increase or decrease the assessment rate schedule five basis points (annualized) higher or lower than the base rates in order to manage the DIF to prescribed statutory target levels.

In December 2008, the FDIC adopted a rule that amended the system for risk-based assessments and changed assessment rates in attempt to restore targeted reserve ratios in the DIF. Effective January 1, 2009, the risk-based assessment rates were uniformly raised by seven basis points (annualized). On February 27, 2009, the FDIC further modified the risk-based assessment system, effective April 1, 2009, to effectively require larger risk institutions to pay a larger share of the assessment. Characteristics of larger risk institutions include a significant reliance on secured liabilities or brokered deposits, particularly when combined with rapid asset growth. The rule also provided incentives for institutions to hold long-term unsecured debt and, for smaller institutions, high levels of Tier 1 capital. The initial base assessment rates range from \$0.12 to \$0.45 per \$100 of deposits annually. The Bank's assessment rate for 2010 fell at the middle of this range.

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After potential adjustments related to unsecured debt, secured liabilities and brokered deposit balances, the final total assessment rates range from \$0.07 to \$0.775 per \$100 of deposits annually. Initial base assessment rates for well managed, well capitalized institutions ranged from \$0.12 to \$0.16 per \$100 of deposits annually.

In October 2010, the FDIC adopted a new DIF restoration plan to ensure that the fund reserve ratio reaches 1.35% by September 30, 2020, as required by the Dodd-Frank Act. Under the new restoration plan, the FDIC will forego the uniform three-basis point increase in initial assessment rates schedules for January 1, 2011 and maintain the current schedule of assessment rates. At least semi-annually, the FDIC will update its loss and income projections for the DIF and, if needed, increase or decrease assessment rates. On February 7, 2011, the FDIC adopted a final rule modifying the risk-based assessment system from a domestic deposit base to a scorecard based assessment system, effective April 1, 2011. Effective as of April 1, 2011, the Bank was categorized as a small institution as the Bank has less than \$10 billion in assets. The initial base assessment rates range from five to 35 basis points. After potential adjustments related to unsecured debt and brokered deposit balances, the final total assessment rates range from 2.5 to 45 basis points. Initial base assessment rates for large institutions ranged from five to 35 basis points. The Bank's assessment rate for 2011 fell at the middle of this range. Further increases in the assessment rate could have a material adverse effect on our earnings, depending upon the amount of the increase.

In 2006, the Reform Act increased the deposit insurance limit for certain retirement plan deposit accounts from \$100,000 to \$250,000. The basic insurance limit for other deposits, including individuals, joint account holders, businesses, government entities, and trusts, remained at \$100,000. The Reform Act also provided for the merger of the two deposit insurance funds administered by the FDIC, the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF), into the DIF. On October 3, 2008, the EESA temporarily raised the basic limit on federal deposit insurance coverage from \$100,000 to \$250,000 per depositor. While the basic deposit insurance limit was to have returned to \$100,000 after December 31, 2009, the Helping Families Save Their Homes Act extended the temporary increase in the standard maximum deposit insurance amount to \$250,000 per depositor through December 31, 2013, and the enactment of the Dodd-Frank Act permanently raised the current standard maximum federal deposit insurance amount from \$100,000 to \$250,000 per qualified account.

In November 2008, the FDIC approved the final ruling establishing the Transaction Account Guarantee Program (TAGP) as part of the Temporary Liquidity Guarantee Program (TLGP). Under this program, all non-interest bearing transaction accounts became fully guaranteed by the FDIC for the entire amount in the account. This unlimited coverage also extended to NOW (interest bearing deposit accounts) earning an interest rate no greater than 0.50% and all IOLTAs (lawyers' trust accounts). TAGP was extended with the enactment of the Dodd-Frank Act provides for unlimited deposit insurance for noninterest bearing transactions accounts (excluding NOW, but including IOLTAs) expiring on December 31, 2012.

The FDIC may terminate the deposit insurance of any insured depository institution if it determines that the institution has engaged in or is engaging in unsafe and unsound banking practices, is in an unsafe or unsound condition or has violated any applicable law, regulation or order or any condition imposed in writing by, or pursuant to, any written agreement with the FDIC. The termination of deposit insurance for the Bank could have a material adverse effect on our financial condition and results of operations due to the fact that the Bank's liquidity position would likely be affected by deposit withdrawal activity.

Capital Adequacy. The FDIC has risk-based capital adequacy guidelines intended to provide a measure of capital adequacy that reflects the degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, and transactions, such as letters of credit and recourse arrangements, which are reported as off-balance-sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off-balance-sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. government securities, to 100% for assets with relatively higher credit risk, such as business loans.

A banking organization's risk-based capital ratios are obtained by dividing its qualifying capital by its total risk-adjusted assets and off-balance-sheet items. The regulators measure risk-adjusted assets and off-balance-sheet items against both total qualifying capital (the sum of Tier 1 capital and limited amounts of Tier 2 capital) and Tier 1 capital. Tier 1 capital consists of common stock, retained earnings, noncumulative perpetual preferred stock and minority interests in certain subsidiaries, less most other intangible assets. Tier 2 capital may consist of a limited amount of the allowance for loan and lease losses and certain other instruments with some characteristics of equity. The inclusion of elements of Tier 2 capital is subject to certain other requirements and limitations of the federal banking agencies. Since December 31, 1992, the FRB and the FDIC have required a minimum ratio of qualifying total capital to risk-adjusted assets and off-balance-sheet items of 8%, and a minimum ratio of Tier 1 capital to risk-adjusted assets and off-balance-sheet items of 4%.

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In addition to the risk-based guidelines, the FRB requires banking organizations to maintain a minimum amount of Tier 1 capital to average total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets is 3%. It is improbable; however, that an institution with a 3% leverage ratio would receive the highest rating by the regulators since a strong capital position is a significant part of the regulators' ratings. For all banking organizations not rated in the highest category, the minimum leverage ratio is at least 100 to 200 basis points above the 3% minimum. Thus, the effective minimum leverage ratio, for all practical purposes, is at least 4% or 5%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the FRB and FDIC have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios.

A bank that does not achieve and maintain the required capital levels may be issued a capital directive by the FRB and/or DFI to ensure the maintenance of required capital levels. As discussed above, the Company and the Bank are required to maintain certain levels of capital, as is the Bank. The regulatory capital guidelines as well as the actual capitalization for the Bank and Bancorp as of December 31, 2011 follow:

	September 30, Requirement for the Bank to be:	September 30, Well Capitalized	September 30, Plumas Bank	September 30, Plumas Bancorp
Tier 1 leverage capital ratio	Adequately Capitalized	4.0%	5.0%	9.8%
Tier 1 risk-based capital ratio		4.0%	6.0%	13.7%
Total risk-based capital ratio		8.0%	10.0%	15.0%

Management believes that the Company and the Bank met all of the above capital adequacy requirements as of December 31, 2011 and 2010.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires federal banking regulators to take prompt corrective action with respect to a capital-deficient institution, including requiring a capital restoration plan and restricting certain growth activities of the institution. The Company could be required to guarantee any such capital restoration plan required of the Bank if the Bank became undercapitalized. Pursuant to FDICIA, regulations were adopted defining five capital levels: well capitalized, adequately capitalized, undercapitalized, severely undercapitalized and critically undercapitalized. Under the regulations, the Bank is considered Well Capitalized as of December 31, 2011.

If capital falls below the minimum levels established by these regulatory capital guidelines, a holding company or a bank may be denied approval to acquire or establish additional banks or non-bank businesses or to open new facilities.

Banks with capital ratios below the required minimums are subject to certain administrative actions, including prompt corrective action, the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing.

Effects of Government Monetary Policy. Our earnings and growth are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government, particularly the Federal Reserve. The Federal Reserve implements national monetary policy for such purposes as curbing inflation and combating recession, through its open market operations in U.S. Government securities, control of the discount rate applicable to borrowings from the Federal Reserve, and establishment of reserve requirements against certain deposits. These activities influence growth of bank loans, investments and deposits, and also affect interest rates charged on loans or paid on deposits. The nature and impact of future changes in monetary policies and their impact on us cannot be predicted with certainty.

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Consumer Protection Laws and Regulations. The banking regulatory agencies are focusing greater attention on compliance with consumer protection laws and their implementing regulations. Examination and enforcement have become more intense in nature, and insured institutions have been advised to monitor carefully compliance with such laws and regulations. The Company is subject to many federal and state consumer protection and privacy statutes and regulations, some of which are discussed below.

The *Equal Credit Opportunity Act* (the ECOA) generally prohibits discrimination in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs, or good faith exercise of any rights under the Consumer Credit Protection Act.

The *Truth in Lending Act* (the TILA) is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As a result of the TILA, all creditors must use the same credit terminology to express rates and payments, including the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule, among other things.

The *Fair Housing Act* (the FH Act) regulates many practices, including making it unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. A number of lending practices have been found by the courts to be, or may be considered, illegal under the FH Act, including some that are not specifically mentioned in the FH Act itself.

The *Home Mortgage Disclosure Act* (the HMDA), in response to public concern over credit shortages in certain urban neighborhoods, requires public disclosure of information that shows whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. The HMDA also includes a fair lending aspect that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes.

The *Right to Financial Privacy Act* (the RFPA) imposes a new requirement for financial institutions to provide new privacy protections to consumers. Financial institutions must provide disclosures to consumers of its privacy policy, and state the rights of consumers to direct their financial institution not to share their nonpublic personal information with third parties.

Finally, the *Real Estate Settlement Procedures Act* (the RESPA) requires lenders to provide noncommercial borrowers with disclosures regarding the nature and cost of real estate settlements. Also, RESPA prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts.

Penalties for noncompliance or violations under the above laws may include fines, reimbursement and other penalties. Due to heightened regulatory concern related to compliance with CRA, ECOA, TILA, FH Act, HMDA, RFPA and RESPA generally, the Company may incur additional compliance costs or be required to expend additional funds for investments in its local communities.

Recent Legislation and Other Changes. Federal and state laws affecting banking are enacted from time to time, and similarly federal and state regulations affecting banking are also adopted from time to time. The following include some of the recent laws and regulations affecting banking.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), signed into law in July, 2010, will significantly change the current bank regulatory structure and affect the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act creates of a new interagency council, the Financial System Oversight Council that is charged with identifying and monitoring the systemic risk to the U.S. economy posed by systemically significant, large financial companies, including bank holding companies and non-bank financial companies. The Office of Thrift Supervision will be eliminated and its powers distributed among the Office of the Comptroller of the Currency, the Federal Reserve Board and the FDIC. The legislation also establishes a floor for capital of insured depository institutions that cannot be lower than the standards in effect today, and directs the federal banking regulators to implement new leverage and capital requirements within 18 months that take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives.

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The Dodd-Frank Act also creates a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rulemaking authority for a wide range of consumer protection laws that apply to all banks and savings institutions such as the Bank, including the authority to prohibit unfair, deceptive or abusive acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Banks and savings institutions with \$10 billion or less in assets will be examined by their applicable bank regulators. The new legislation also weakens the federal preemption available for national banks and federal savings associations, and gives state attorneys general the ability to enforce applicable federal consumer protection laws.

The legislation 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. The Dodd-Frank Act also repeals the prohibition on payment of interest on demand deposits.

Section 613 of the Dodd-Frank Act eliminates interstate branching restrictions that were implemented as part of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, and removes many restrictions on de novo interstate branching by national and state-chartered banks. The FDIC and the OCC now have authority to approve applications by insured state nonmember banks and national banks, respectively, to establish de novo branches in states other than the bank's home state if the law of the State in which the branch is located, or is to be located, would permit establishment of the branch, if the bank were a State bank chartered by such State. The enactment of this section may significantly increase interstate banking by community banks in western states, where barriers to entry were previously high.

Many of the provisions of the Dodd-Frank Act will not take effect for at least a year, and the legislation requires various federal agencies to promulgate numerous and extensive implementing regulations over the next several years. Although the substance and scope of these regulations cannot be determined at this time, it is expected that the legislation and implementing regulations, particularly those provisions relating to the new Consumer Financial Protection Bureau, will increase the Bank's operating and compliance costs as it is likely that the Bank's existing regulatory agencies will adopt the same or similar consumer protections as the new Consumer Financial Protection Bureau will adopt.

On June 21, 2010, the federal banking agencies issued final guidance on incentive compensation. The final guidance is largely unchanged from the FRB's preliminary guidance published in 2009, with the exception of a few adjustments/clarifications in response to feedback the FRB received during the open comment period. The guidance became effective on June 25, 2010 (the date published in the Federal Register, and applies to all banks. Except for the largest banking organizations, enforcement of this guidance will be handled through the supervisors' regular risk-focused examination process. The guidance is principles-based, rather than prescriptive, and also identifies expectations of large banking organizations that go beyond what will be expected of community banks, and emphasizes that the application of the guidance should be scaled appropriately for the complexity of the organization and the extent to which incentive arrangements are utilized. The employees covered by the final guidance are senior executives and others who are responsible for oversight of the organization's firm-wide activities or material business lines; individual employees, including non-executive employees, whose activities may expose the organization to material amounts of risk; and groups of employees who are subject to the same or similar incentive compensation arrangements and who, in the aggregate, may expose the organization to material amounts of risk, even if no individual employee is likely to expose the organization to material risk. The guidance provides for three principles for safe and sound incentive compensation arrangements:

Balanced Risk-Taking: Incentive compensation arrangements should balance risk and financial results in a manner that does not encourage employees to expose their organizations to imprudent risks;

Compatibility with Effective Controls and Risk-Management: A banking organization's risk-management processes and internal controls should reinforce and support the development and maintenance of balanced incentive compensation arrangements;

Strong Corporate Governance: Banking organizations should have strong and effective corporate governance to help ensure sound compensation practices, including active and effective oversight by the board of directors.

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The Electronic Funds Transfer Act (the EFTA) provides a basic framework for establishing the rights, liabilities, and responsibilities of consumers who use electronic funds transfer (EFT) systems. The EFTA is implemented by the Federal Reserve s Regulation E, which governs transfers initiated through ATMs, point-of-sale terminals, payroll cards, automated clearinghouse (ACH) transactions, telephone bill-payment plans, or remote banking services. Regulation E was amended in January 2010 to require consumers to opt in (affirmatively consent) to participation in the Bank s overdraft service program for ATM and one-time debit card transactions before overdraft fees may be assessed on the consumer s account. Notice of the opt-in right must be provided to all existing and new customers who are consumers, and the customer s affirmative consent must be obtained, before charges may be assessed on the consumer s account for paying such overdrafts.

The new rule provides bank customers with an ongoing right to revoke consent to participation in an overdraft service program for ATM and one-time debit card transactions, as opposed to being automatically enrolled in such a program. The new rule also prohibits banks from conditioning the payment of overdrafts for checks, ACH transactions, or other types of transactions that overdraw the consumer s account on the consumer s opting into an overdraft service for ATM and one-time debit card transactions. For customers who do not affirmatively consent to overdraft service for ATM and one-time debit card transactions, a bank must provide those customers with the same account terms, conditions, and features that it provides to consumers who do affirmatively consent, except for the overdraft service for ATM and one-time debit card transactions.

The mandatory compliance date for the Regulation E amendments is July 1, 2010 provided that the Bank may continue to assess overdraft service fees or charges on existing customer accounts prior to August 15, 2010, without obtaining the consumer s affirmative consent. The Bank s compliance with the new Regulation E amendments may have an impact on the Bank s revenue from overdraft service fees and non-sufficient funds (NSF) charges.

In May 2009 the Helping Families Save Their Homes Act of 2009 was enacted to help consumers avoid mortgage foreclosures on their homes through certain loss mitigation actions including special forbearance, loan modification, pre-foreclosure sale, deed in lieu of foreclosure, support for borrower housing counseling, subordinate lien resolution, and borrower relocation. The new law permits the Secretary of Housing and Urban Development (HUD), for mortgages either in default or facing imminent default, to: (1) authorize the modification of such mortgages; and (2) establish a program for payment of a partial claim to a mortgagee who agrees to apply the claim amount to payment of a mortgage on a 1- to 4-family residence. In implementing the law, the Secretary of HUD is authorized to (1) provide compensation to the mortgagee for lost income on monthly mortgage payments due to interest rate reduction; (2) reimburse the mortgagee from a guaranty fund in connection with activities that the mortgagee is required to undertake concerning repayment by the mortgagor of the amount owed to HUD; (3) make payments to the mortgagee on behalf of the borrower, under terms defined by HUD; and (4) make mortgage modification with terms extended up to 40 years from the modification date. The new law also authorizes the Secretary of HUD to: (1) reassign the mortgage to the mortgagee; (2) act as a Government National Mortgage Association (GNMA, or Ginnie Mae) issuer, or contract with an entity for such purpose, in order to pool the mortgage into a Ginnie Mae security; or (3) resell the mortgage in accordance with any program established for purchase by the federal government of insured mortgages. The new law also amends the Foreclosure Prevention Act of 2008, with respect to emergency assistance for the redevelopment of abandoned and foreclosed homes (neighborhood stabilization), to authorize each state that has received certain minimum allocations and has fulfilled certain requirements, to distribute any remaining amounts to areas with homeowners at risk of foreclosure or in foreclosure without regard to the percentage of home foreclosures in such areas.

Also in May 2009, the Credit Card Act of 2009 was enacted to help consumers and ban certain practices of credit card issuers. The new law allows interest rate hikes on existing balances only under limited conditions, such as when a promotional rate ends, there is a variable rate or if the cardholder makes a late payment. Interest rates on new transactions can increase only after the first year. Significant changes in terms on accounts cannot occur without 45 days advance notice of the change. The new law bans raising interest rates on customers based on their payment records with other unrelated credit issuers (such as utility companies and other creditors) for existing credit card balances, though card issuers would still be allowed to use universal default on future credit card balances if they give at least 45 days advance notice of the change. The new law allows consumers to opt out of certain significant changes in terms on their accounts. Opting out means cardholders agree to close their accounts and pay off the balance under the old terms. They have at least five years to pay the balance. Credit card issuers will be banned from issuing credit cards to anyone under 21, unless they have adult co-signers on the accounts or can show proof they have enough income to repay the card debt.

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The new law requires card issuers to give card account holders a reasonable amount of time to make payments on monthly bills. That means payments would be due at least 21 days after they are mailed or delivered. Credit card issuers would no longer be able to set early morning or other arbitrary deadlines for payments. When consumers have accounts that carry different interest rates for different types of purchases payments in excess of the minimum amount due must go to balances with higher interest rates first. Consumers must opt in to over-limit fees. Those who opt out would have their transactions rejected if they exceed their credit limits, thus avoiding over-limit fees. Fees charged for going over the limit must be reasonable. Finance charges on outstanding credit card balances would be computed based on purchases made in the current cycle rather than going back to the previous billing cycle to calculate interest charges. Fees on credit cards cannot exceed 25 percent of the available credit limit in the first year of the card.

On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was enacted to provide stimulus to the struggling US economy. ARRA authorizes spending of \$787 billion, including about \$288 billion for tax relief, \$144 billion for state and local relief aid, and \$111 billion for infrastructure and science. In addition, ARRA includes additional executive compensation restrictions for recipients of funds from the US Treasury under the Troubled Assets Relief Program of the Emergency Economic Stimulus Act of 2008 (EESA).

EESA was amended by ARRA to provide additional incentive compensation restrictions for financial institutions receiving TARP funds and also require additional corporate governance provisions with respect to limiting golden parachutes, lavish expenditures and requiring officer certifications of compliance and clawbacks for improperly earned incentive compensation at such institutions.

In addition, EESA as amended by ARRA provides that for any TARP recipient, its annual meeting materials shall include a nonbinding shareholder approval proposal of executive compensation for shareholders to vote.

ARRA also provides \$730 million to the SBA and makes changes to the agency's lending and investment programs so that they can reach more small businesses that need help. The funding includes:

\$375 million for temporarily eliminating fees on SBA-backed loans and raising SBA's guarantee percentage on some loans to 90 percent.

\$255 million for a new loan program to help small businesses meet existing debt payments

\$30 million for expanding SBA's Microloan program, enough to finance up to \$50 million in new lending and \$24 million in technical assistance grants to microlenders.

In October 2008, the President signed the Emergency Economic Stabilization Act of 2008 (EESA), in response to the global financial crisis of 2008 authorizing the United States Secretary of the Treasury with authority to spend up to \$700 billion to purchase distressed assets, especially mortgage-backed securities, under the Troubled Assets Relief Program (TARP) and make capital injections into banks under the Capital Purchase Program. EESA gives the government the unprecedented authority to buy troubled assets on balance sheets of financial institutions under the Troubled Assets Relief Program. Some of the other provisions of EESA are as follows:

accelerated from 2011 to 2008 the date that the Federal Reserve Bank could pay interest on deposits of banks held with the Federal Reserve to meet reserve requirements;

to the extent that the U. S. Treasury purchases mortgage securities as part of TARP, the Treasury shall implement a plan to minimize foreclosures including using guarantees and credit enhancements to support reasonable loan modifications, and to the extent loans are owned by the government to consent to the reasonable modification of such loans;

limits executive compensation for executives for TARP participating financial institutions;

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extends the mortgage debt forgiveness provision of the Mortgage Forgiveness Debt Relief Act of 2007 by three years (2012) to ease the income tax burden on those involved with certain foreclosures; and

On January 1, 2012, SB 664 (Committee on Banking and Financial Institutions, Chapter 243, Statutes of 2011) became operative. While some substantive changes were included in this legislation due to the passage of the Dodd-Frank federal legislation and some technical corrections that resulted from earlier amendments to the Code, the majority of the work involved in SB 664 was to reorder the section numbering in the Code. Among other things, the law requires a bank that establishes a branch office in this state in accordance with the National Bank Act, as amended by the Dodd-Frank Act to provide a specified notice to the Commissioner of DFI within 10 days of the establishment, relocation, or redesignation of offices.

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In California, the enactment of AB329 in 2009, the Reverse Mortgage Elder Protection Act of 2009 prohibits a lender or any other person who participates in the origination of the mortgage from participation in, being associated with, or employing any party that participates in or is associated with any other financial or insurance activity or referring a prospective borrower to anyone for the purchase of other financial or insurance products; and imposes certain disclosure requirements on the lender.

The enactment of AB1160 in 2009, requires a supervised financial institution in California that negotiates primarily in any of a number of specified languages in the course of entering into a contract or agreement for a loan or extension of credit secured by residential real property, to deliver, prior to the execution of the contract or agreement, and no later than 3 business days after receiving the written application, a specified form in that language summarizing the terms of the contract or agreement; provides for administrative penalties for violations; and requires the California Department of Corporations and the Department of Financial Institutions to create a form for providing translations and make it available in Spanish, Chinese, Tagalog, Vietnamese and Korean. The statute becomes operative on July 1, 2010, or 90 days after issuance of the form, whichever occurs later.

The enactment of AB 1291 in 2009 makes changes to the California Unclaimed Property Law including (among other things): allowing electronic notification to customers who have consented to electronic notice; requiring that notices contain certain information and allow the holder to provide electronic means to enable the owner to contact the holder in lieu of returning the prescribed form to declare the owner's intent; authorizing the holder to give additional notices; and requiring, beginning January 1, 2011, a banking or financial organization to provide a written notice regarding escheat at the time a new account or safe deposit box is opened.

The enactment of SB306 makes specified changes to clarify existing law related to filing a notice of default on residential real property in California, including (among other things): clarifying that the provisions apply to mortgages and deeds of trust recorded from January 1, 2003 through December 31, 2007, secured by owner-occupied 3-4 residential real property containing no more than 4 dwelling units; revising the declaration to be filed with the notice of default; specifying how the loan servicers have to maximize net present value under their pooling and servicing agreements applies to certain investors; specifying how and when the notice to residents of property subject to foreclosure is to be mailed; and extending the time during which the notice of sale must be recorded from 14 to 20 days. The bill also makes certain changes related to short-pay agreements and short-pay demand statements.

On February 20, 2009, Governor Schwarzenegger signed ABX2-7 and SBX2-7, which established the California Foreclosure Prevention Act. The California Foreclosure Prevention Act modifies the foreclosure process to provide additional time for borrowers to work out loan modifications while providing an exemption for mortgage loan servicers that have implemented a comprehensive loan modification program. Civil Code Section 2923.52 requires an additional 90 day period beyond the period already provided before a Notice of Sale can be given in order to allow all parties to pursue a loan modification to prevent foreclosure of loans meeting certain criteria identified in that section.

A mortgage loan servicer who has implemented a comprehensive loan modification program may file an application for exemption from the provisions of Civil Code Section 2923.52. Approval of this application provides the mortgage loan servicer an exemption from the additional 90-day period before filing the Notice of Sale when foreclosing on real property covered by the new law.

Recent Accounting Pronouncements

See Note 3 – Summary of Significant Accounting Policies – Adoption of New Accounting Standards of the Company's Consolidated Financial Statements in Item 8 – Financial Statements and Supplementary Data of this Annual Report on Form 10K for information related to recent accounting pronouncements.

ITEM 1A. RISK FACTORS

As a smaller reporting company we are not required to provide the information required by this item.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

No comments have been submitted to the registrant by the staff of the Securities Exchange Commission.

ITEM 2. PROPERTIES

Of the Company's eleven depository branches, ten are owned and one is leased. The Company also leases one lending office and one administrative office, and owns four administrative facilities.

Owned Properties

35 South Lindan Avenue Quincy, California (1)	32 Central Avenue Quincy, California (1)	80 W. Main St. Quincy, California (3)
424 N. Mill Creek Quincy, California (1)	336 West Main Street Quincy, California	120 North Pine Street Portola, California
43163 Highway 299E Fall River Mills, California	121 Crescent Street Greenville, California	255 Main Street Chester, California
510 North Main Street Alturas, California	3000 Riverside Drive Susanville, California	8475 North Lake Boulevard Kings Beach, California
11638 Donner Pass Road Truckee, California	2175 Civic Center Drive Redding, California	

Leased Properties

243 North Lake Boulevard Tahoe City, California	1005 Terminal Way, Ste. 246 Reno, Nevada (1)	470 Nevada St., Suite 108 Auburn, California (2)
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(1) Non-branch administrative or credit administrative offices.

(2) Commercial lending office.

(3) Leased to a third party.

Total rental expenses under all leases, including premises, totaled \$150,000, \$20,000 and \$317,000, in 2011, 2010 and 2009 respectively. The decline in rental expense during 2010 resulted from the purchase of our Redding branch building on March 31, 2010. Previously we had leased this building. Under the terms of the lease agreement we were provided free rent for a period of time; however, in accordance with accounting principals we recognized monthly rent expense equal to the total payments required under the lease dividend by the term of the lease in months. At the time of the purchase we reversed this accrual recognizing a \$184 thousand reduction in rental expense. The expiration dates of the leases vary, with the first such lease expiring during 2012 and the last such lease expiring during 2015.

Future minimum lease payments in thousands of dollars are as follows:

Year Ending

September 30,

December 31,

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2012	\$	147,000
2013		75,000
2014		51,000
2015		51,000
	\$	324,000

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The Company maintains insurance coverage on its premises, leaseholds and equipment, including business interruption and record reconstruction coverage. The branch properties and non-branch offices are adequate, suitable, in good condition and have adequate parking facilities for customers and employees. The Company and Bank are limited in their investments in real property under Federal and state banking laws. Generally, investments in real property are either for the Company and Bank use or are in real property and real property interests in the ordinary course of the Bank's business.

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company and/or its subsidiary are a party to claims and legal proceedings arising in the ordinary course of business. In the opinion of the Company's management, the amount of ultimate liability with respect to such proceedings will not have a material adverse effect on the financial condition or results of operations of the Company taken as a whole.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCK-HOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

The Company's common stock is quoted on the NASDAQ Capital Market under the ticker symbol PLBC. As of December 31, 2011, there were 4,776,339 shares of the Company's stock outstanding held by approximately 1,640 shareholders of record as of the same date. The following table shows the high and low sales prices for the common stock, for each quarter as reported by Yahoo Finance.

Quarter	September 30, Common Dividends	September 30, High	September 30, Low
4 th Quarter 2011		\$ 2.92	\$ 1.63
3 rd Quarter 2011		\$ 2.72	\$ 1.46
2 nd Quarter 2011		\$ 2.85	\$ 1.94
1 st Quarter 2011		\$ 4.00	\$ 1.85
4 th Quarter 2010		\$ 3.09	\$ 1.92
3 rd Quarter 2010		\$ 3.22	\$ 2.53
2 nd Quarter 2010		\$ 3.39	\$ 2.46
1 st Quarter 2010		\$ 3.78	\$ 2.21

Dividends paid to shareholders by the Company are subject to restrictions set forth in California General Corporation Law, which provides that a corporation may make a distribution to its shareholders if retained earnings immediately prior to the dividend payout are at least equal to the amount of the proposed distribution. As a bank holding company without significant assets other than its equity position in the Bank, the Company's ability to pay dividends to its shareholders depends primarily upon dividends it receives from the Bank.

It is the policy of the Company to periodically distribute excess retained earnings to the shareholders through the payment of cash dividends. Such dividends help promote shareholder value and capital adequacy by enhancing the marketability of the Company's stock. All authority to provide a return to the shareholders in the form of a cash or stock dividend or split rests with the Board of Directors (the Board). The Board will periodically, but on no regular schedule and in accordance with regulatory restrictions, if any, review the appropriateness of a cash dividend payment. No common cash dividends were paid in 2010 or 2011 and none are anticipated to be paid in 2012.

The Company is subject to various restrictions on the payment of dividends. See Note 2 Regulatory Matters and Note 13 Shareholders' Equity Dividend Restrictions of the Company's Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data of this Annual Report on Form 10K.

On January 30, 2009, under the Capital Purchase Program, the Company entered into a Letter Agreement (the Purchase Agreement) with the United States Department of the Treasury (Treasury), pursuant to which the Company issued and sold (i) 11,949 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Shares) and (ii) a ten-year warrant to purchase up to 237,712 shares of the Company's common stock, no par value at an exercise price, subject to anti-dilution adjustments, of \$7.54 per share, for an aggregate purchase price of \$11,949,000 in cash. The Series A Preferred Stock and the Warrant were issued in a private placement exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended. As described in the following paragraph the Purchase Agreement contains provisions that restrict the payment of dividends on Plumas Bancorp common stock and restrict the Company's ability to repurchase Plumas Bancorp common stock.

Under the Purchase Agreement, prior to January 30, 2012, unless the Company has redeemed the Preferred Shares, or the Treasury has transferred the Preferred Shares to a third party, the consent of the Treasury will be required for the Company to: (1) declare or pay any dividend or make any distribution on shares of the Common Stock (other than regular quarterly cash dividends of not more than \$0.04 per share or regular semi-annual cash dividends of not more than \$0.08 per share); or (2) redeem, purchase or acquire any shares of Common Stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the Purchase Agreement.

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Securities Authorized for Issuance under Equity Compensation Plans. The following table sets forth securities authorized for issuance under equity compensation plans as of December 31, 2011.

Plan Category	September 30,	September 30,	September 30,
	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	482,780	\$ 8.74	0
Equity compensation plans not approved by security holders	None	Not Applicable	None
Total	482,780	\$ 8.74	0

For additional information related to the above plans see Note 13 of the Company's Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data of this Annual Report on Form 10K.

Issuer Purchases of Equity Securities. There were no purchases of Plumas Bancorp common stock by the Company during 2011.

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The following table presents a summary of selected financial data and should be read in conjunction with the Company's consolidated financial statements and notes thereto included under Item 8 Financial Statements and Supplementary Data.

	September 30, 2011	September 30, 2010	September 30, 2009	September 30, 2008	September 30, 2007
	At or for the year ended December 31,				
	(dollars in thousands except per share information)				
Statement of Operations					
Interest income	\$ 18,668	\$ 20,680	\$ 22,836	\$ 25,440	\$ 30,284
Interest expense	1,848	3,147	3,655	5,364	8,536
Net interest income	16,820	17,533	19,181	20,076	21,748
Provision for loan losses	3,500	5,500	14,500	4,600	800
Noninterest income	7,162	8,468	5,664	5,091	5,448
Noninterest expense	19,246	19,141	26,266	20,475	19,671
Provision for (benefit from) income taxes	295	389	(6,775)	(212)	2,502
Net income (loss)	\$ 941	\$ 971	\$ (9,146)	\$ 304	\$ 4,223
Preferred Stock dividends and discount accretion	684	684	628		
Net income (loss) available to common shareholders	\$ 257	\$ 287	\$ (9,774)	\$ 304	\$ 4,223
Balance sheet (end of period)					
Total assets	\$ 455,349	\$ 484,480	\$ 528,117	\$ 457,175	\$ 453,115
Total loans	\$ 293,865	\$ 314,200	\$ 332,678	\$ 366,017	\$ 352,949
Allowance for loan losses	\$ 6,908	\$ 7,324	\$ 9,568	\$ 7,224	\$ 4,211
Total deposits	\$ 391,140	\$ 424,887	\$ 433,255	\$ 371,493	\$ 391,940
Total shareholders' equity	\$ 39,634	\$ 37,988	\$ 38,231	\$ 35,437	\$ 37,139
Balance sheet (period average)					
Total assets	\$ 467,354	\$ 500,082	\$ 490,000	\$ 447,720	\$ 464,974
Total loans	\$ 302,841	\$ 323,906	\$ 354,482	\$ 355,416	\$ 353,384
Total deposits	\$ 407,982	\$ 430,777	\$ 403,896	\$ 382,279	\$ 403,772
Total shareholders' equity	\$ 39,244	\$ 38,941	\$ 43,839	\$ 37,343	\$ 37,041
Capital ratios					
Leverage ratio	9.8%	8.9%	7.9%	9.8%	10.0%
Tier 1 risk-based capital	13.7%	12.7%	10.4%	11.0%	11.6%
Total risk-based capital	15.0%	13.9%	11.6%	12.2%	12.7%
Asset quality ratios					
Nonperforming loans/total loans	5.73%	8.07%	4.30%	7.31%	0.75%
Nonperforming assets/total assets	5.60%	7.07%	4.84%	6.78%	0.70%
Allowance for loan losses/total loans	2.35%	2.33%	2.88%	1.97%	1.19%
Net loan charge-offs	\$ 3,916	\$ 7,744	\$ 12,156	\$ 1,587	\$ 506
Performance ratios					
Return (loss) on average assets	0.20%	0.19%	(1.87)%	0.07%	0.91%
Return (loss) on average common equity	0.9%	1.1%	(29.5)%	0.8%	11.4%
Return (loss) on average equity	2.4%	2.5%	(20.9)%	0.8%	11.4%
Net interest margin	4.08%	4.24%	4.52%	4.99%	5.18%
Loans to deposits	75.1%	73.9%	76.8%	98.5%	90.1%
Efficiency ratio	80.3%	73.6%	105.7%	81.4%	72.3%
Per share information					
Basic earnings (loss)	\$ 0.05	\$ 0.06	\$ (2.05)	\$ 0.06	\$ 0.85

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Diluted earnings (loss)	\$	0.05	\$	0.06	\$	(2.05)	\$	0.06	\$	0.84
Common cash dividends	\$	0.00	\$	0.00	\$	0.00	\$	0.24	\$	0.30
Dividend payout ratio		%		%		%		400%		35.3%
Book value per common share	\$	5.83	\$	5.51	\$	5.58	\$	7.42	\$	7.63
Common shares outstanding at period end		4,776,339		4,776,339		4,776,339		4,775,339		4,869,130

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

General

We are a bank holding company for Plumas Bank, a California state-chartered commercial bank. We derive our income primarily from interest received on real estate related, commercial and consumer loans and, to a lesser extent, interest on investment securities, fees received in connection with servicing deposit and loan customers and fees from the sale of loans. Our major operating expenses are the interest we pay on deposits and borrowings and general operating expenses. We rely on locally-generated deposits to provide us with funds for making loans.

We are subject to competition from other financial institutions and our operating results, like those of other financial institutions operating in California, are significantly influenced by economic conditions in California, including the strength of the real estate market. In addition, both the fiscal and regulatory policies of the federal and state government and regulatory authorities that govern financial institutions and market interest rates also impact the Bank's financial condition, results of operations and cash flows.

Critical Accounting Policies

Our accounting policies are integral to understanding the financial results reported. Our most complex accounting policies require management's judgment to ascertain the valuation of assets, liabilities, commitments and contingencies. We have established detailed policies and internal control procedures that are intended to ensure valuation methods are applied in an environment that is designed and operating effectively and applied consistently from period to period. The following is a brief description of our current accounting policies involving significant management valuation judgments.

Allowance for Loan Losses. The allowance for loan losses is an estimate of credit losses inherent in the Company's loan portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are collectively evaluated for impairment.

We evaluate our allowance for loan losses quarterly. We believe that the allowance for loan losses is a critical accounting estimate because it is based upon management's assessment of various factors affecting the collectibility of the loans, including current economic conditions, past credit experience, delinquency status, the value of the underlying collateral, if any, and a continuing review of the portfolio of loans.

We cannot provide you with any assurance that economic difficulties or other circumstances which would adversely affect our borrowers and their ability to repay outstanding loans will not occur which would be reflected in increased losses in our loan portfolio, which could result in actual losses that exceed reserves previously established.

Other Real Estate Owned. Other real estate owned (OREO) represents properties acquired through foreclosure or physical possession. OREO is initially recorded at fair value less costs to sell when acquired. Write-downs to fair value at the time of transfer to OREO is charged to allowance for loan losses. Subsequent to foreclosure, we periodically evaluate the value of OREO held for sale and record a valuation allowance for any subsequent declines in fair value less selling costs. Subsequent declines in value are charged to operations. Fair value is based on our assessment of information available to us at the end of a reporting period and depends upon a number of factors, including our historical experience, economic conditions, and issues specific to individual properties. Our evaluation of these factors involves subjective estimates and judgments that may change.

Income Taxes. The Company files its income taxes on a consolidated basis with its subsidiary. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for income taxes.

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Deferred income taxes reflect the estimated future tax effects of temporary differences between the reported amount of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. We use an estimate of future earnings to support our position that the benefit of our deferred tax assets will be realized. A valuation allowance is recognized if, based on the weight of available evidence, management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized. If future income should prove non-existent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and our net income will be reduced.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

The following discussion is designed to provide a better understanding of significant trends related to the Company's financial condition, results of operations, liquidity and capital. It pertains to the Company's financial condition, changes in financial condition and results of operations as of December 31, 2011 and 2010 and for each of the three years in the period ended December 31, 2011. The discussion should be read in conjunction with the Company's audited consolidated financial statements and notes thereto and the other financial information appearing elsewhere herein.

Overview

The Company recorded net income of \$941 thousand for the year ended December 31, 2011, a slight decrease from net income of \$971 thousand during the year ended December 31, 2010 but up \$10.1 million over 2009's net loss of \$9.1 million. Excluding a \$1.4 million gain (\$0.8 million net of tax) in 2010 on sale of the Bank's merchant card portfolio, net income would have increased by \$0.8 million over 2010.

Net interest income declined by \$713 thousand from \$17.5 million during 2010 to \$16.8 million for the year ended December 31, 2011. This decrease in net interest income was mostly related to a \$21 million decline in average loan balances. During the year ended December 31, 2011 non-interest income decreased by \$1.3 million to \$7.2 million, from \$8.5 million during the year ended December 31, 2010. This decrease was related to a \$1.4 million gain on the sale of our merchant processing portfolio in 2010. Additionally, gain on sale of investment securities declined by \$494 thousand from \$1.2 million in 2010 to \$0.7 million for the year ended December 31, 2011. Partially offsetting these declines in non-interest income was an \$884 thousand increase in gain on sale of government guaranteed loans from \$1.1 million in 2010 to \$1.9 million in 2011. Non-interest expense increased by \$105 thousand from \$19.1 million during the year ended December 31, 2010 to \$19.2 million during the current twelve month period. While we have achieved savings in many categories of non-interest expense these were offset in the current year by an increase of \$649 thousand in loss on sale of OREO.

The most significant expense reduction was a \$2.0 million decrease in our provision for loan losses from \$5.5 million for the year ended December 31, 2010 to \$3.5 million during 2011. The \$3.5 million provision recorded for the year ended December 31, 2011 primarily relates to net charge-offs during the twelve month period. We have experienced a \$3.8 million decrease in net charge-offs during the comparison years. Net charge-offs declined from \$7.7 million during 2010 to \$3.9 million during the year ended December 31, 2011. Net charge-offs as percentage of average loans decreased significantly from 2.39% during the twelve months ended December 31, 2010 to 1.29% during the current year.

The provision for income taxes declined from \$389 thousand in 2010 to \$295 thousand during the year ended December 31, 2011.

Net income allocable to common shareholders decreased slightly from \$287 thousand during the year ended December 31, 2010 to \$257 thousand during 2011. Income allocable to common shareholders is calculated by subtracting dividends and discount amortized on preferred stock from net income.

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Total assets at December 31, 2011 decreased \$29.1 million, or 6% to \$455 million. Decreases include \$5.1 million in investment securities, \$19.7 million in net loans, \$1.6 million in cash and due from banks and \$2.7 million in all other assets. Net loans decreased by 6% from \$307 million at December 31, 2010 to \$287 million at December 31, 2011. This decline in net loans was mostly related to normal pay downs and prepayments, loan charge-offs, real estate acquired through foreclosure and our continued efforts to reduce the level of construction and land development loan balances. At December 31, 2011 investment securities totaled \$57.9 million compared to \$63.0 million at December 31, 2010. Investment securities are composed of debt securities issued by agencies sponsored by the U.S. Government.

Total deposits were \$391 million as of December 31, 2011, a decrease of \$33.7 million, or 8%, from the December 31, 2010 balance of \$425 million. The decline in deposits was primarily related to maturities from a higher rate promotional time deposit product we began offering in June, 2009 and continued to offer until April 30, 2010. Core deposit growth was strong with increases in non-interest bearing deposits of \$14.1 million and savings deposits of \$10.8 million. Non-interest bearing deposits as a percentage of total deposits increased from 26.3% at December 31, 2010 to 32.2% at December 31, 2011.

Shareholders' equity as of December 31, 2011 increased by \$1.6 million to \$39.6 million up from \$38.0 million as of December 31, 2010. This increase was mostly related to earnings during the period, the reversal of \$524 thousand in accrued preferred stock dividends and an increase of \$210 thousand in accumulated other comprehensive income/loss from a loss of \$52 thousand at December 31, 2010 to accumulated other comprehensive income of \$158 thousand at December 31, 2011.

The return on average assets was 0.20% for 2011, up from 0.19% for 2010. The return on average common equity was 0.9% for 2011, down from 1.1% for 2010.

Table of Contents**Results of Operations****Net Interest Income**

The following table presents, for the years indicated, the distribution of consolidated average assets, liabilities and shareholders' equity. Average balances are based on average daily balances. It also presents the amounts of interest income from interest-earning assets and the resultant yields expressed in both dollars and yield percentages, as well as the amounts of interest expense on interest-bearing liabilities and the resultant cost expressed in both dollars and rate percentages. Nonaccrual loans are included in the calculation of average loans while nonaccrued interest thereon is excluded from the computation of yields earned:

	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	XXXX
				Year ended December 31,					
	Average	2011	Rates	Average	2010	Rates	Average	2009	Rates
	balance	interest	earned/	balance	interest	earned/	balance	interest	earned/
		income/	paid		income/	paid		income/	paid
		expense			expense			expense	
	(dollars in thousands)								
Assets									
Interest bearing deposits	\$ 49,628	\$ 124	0.25%	\$ 19,808	\$ 48	0.24%	\$ 6,298	\$ 15	0.24%
Federal funds sold							12		
Investment securities ⁽¹⁾	59,439	1,144	1.92	69,357	1,772	2.55	64,047	2,163	3.38
Total loans ⁽²⁾⁽³⁾	302,841	17,400	5.75	323,906	18,860	5.82	354,482	20,658	5.83
Total earning assets	411,908	18,668	4.53%	413,071	20,680	5.01%	424,839	22,836	5.38%
Cash and due from banks	13,204			38,945			27,372		
Other assets	42,242			48,066			37,789		
Total assets	\$ 467,354			\$ 500,082			\$ 490,000		
Liabilities and shareholders' equity									
Interest bearing demand deposits	\$ 93,925	187	0.20%	\$ 101,519	382	0.38%	\$ 98,394	671	0.68%
Money market deposits	40,050	115	0.29	42,514	221	0.52	41,844	346	0.83
Savings deposits	58,996	106	0.18	51,011	86	0.17	50,286	90	0.18
Time deposits	96,961	1,061	1.09	124,810	2,007	1.61	105,313	2,062	1.96
Short-term borrowings				986	5	0.51	24,292	80	0.33
Long-term borrowings				9,973	130	1.30	1,589	27	1.70
Junior subordinated debentures	10,310	326	3.16	10,310	312	3.03	10,310	371	3.60
Other	3,188	53	1.66	123	4	3.25	212	8	3.77
Total interest bearing liabilities	303,430	1,848	0.61%	341,246	3,147	0.92%	332,240	3,655	1.10%
Noninterest bearing demand deposits	118,050			110,923			108,059		
Other liabilities	6,630			8,972			5,862		
Shareholders' equity	39,244			38,941			43,839		
Total liabilities and shareholders' equity	\$ 467,354			\$ 500,082			\$ 490,000		
Net interest income		\$ 16,820			\$ 17,533			\$ 19,181	
Net interest spread ⁽⁴⁾			3.92%			4.09%			4.28%
Net interest margin ⁽⁵⁾			4.08%			4.24%			4.52%

- (1) Interest income is reflected on an actual basis and is not computed on a tax-equivalent basis.
- (2) Average nonaccrual loan balances of \$20.2 million for 2011, \$18.8 million for 2010 and \$25.1 million for 2009 are included in average loan balances for computational purposes.
- (3) Loan origination fees and costs are included in interest income as adjustments of the loan yields over the life of the loan using the interest method. Loan interest income includes net loan fees (costs) of \$49,000, \$(20,000) and \$(214,000) for 2011, 2010 and 2009, respectively.
- (4) Net interest spread represents the average yield earned on interest-earning assets less the average rate paid on interest-bearing liabilities.
- (5) Net interest margin is computed by dividing net interest income by total average earning assets.

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The following table sets forth changes in interest income and interest expense, for the years indicated and the amount of change attributable to variances in volume, rates and the combination of volume and rates based on the relative changes of volume and rates:

	2011 compared to 2010				2010 compared to 2009			
	Increase (decrease) due to change in:				Increase (decrease) due to change in:			
	Average Volume ⁽¹⁾	Average Rate ⁽²⁾	Mix ⁽³⁾	Total	Average Volume ⁽¹⁾	Average Rate ⁽²⁾	Mix ⁽³⁾	Total
	(dollars in thousands)							
Interest-earning assets:								
Interest bearing deposits	\$ 72	\$ 2	\$ 2	\$ 76	\$ 32	\$	\$ 1	\$ 33
Investment securities	(253)	(437)	62	(628)	179	(527)	(43)	(391)
Loans	(1,226)	(250)	16	(1,460)	(1,782)	(18)	2	(1,798)
Total interest income	(1,407)	(685)	80	(2,012)	(1,571)	(545)	(40)	(2,156)
Interest-bearing liabilities:								
Interest bearing demand deposits	(28)	(180)	13	(195)	21	(301)	(9)	(289)
Money market deposits	(13)	(99)	6	(106)	5	(128)	(2)	(125)
Savings deposits	13	6	1	20	1	(5)		(4)
Time deposits	(448)	(641)	143	(946)	382	(369)	(68)	(55)
Short-term borrowings	(5)	(5)	5	(5)	(77)	43	(41)	(75)
Long-term borrowings	(130)	(130)	130	(130)	142	(6)	(33)	103
Junior subordinated debentures		14		14		(59)		(59)
Other borrowings	100	(2)	(49)	49	(3)	(1)		(4)
Total interest expense	(511)	(1,037)	249	(1,299)	471	(826)	(153)	(508)
Net interest income	\$ (896)	\$ 352	\$ (169)	\$ (713)	\$ (2,042)	\$ 281	\$ 113	\$ (1,648)

(1) The volume change in net interest income represents the change in average balance multiplied by the previous year's rate.

(2) The rate change in net interest income represents the change in rate multiplied by the previous year's average balance.

(3) The mix change in net interest income represents the change in average balance multiplied by the change in rate.

2011 compared to 2010. Net interest income is the difference between interest income and interest expense. Net interest income, on a nontax-equivalent basis, was \$16.8 million for the year ended December 31, 2011, a decline of \$0.7 million, or 4.1%, from \$17.5 million for 2010.

The overall change in net interest income was primarily a result of a decrease of \$1.5 million in loan interest income and a decline of \$628 thousand in interest income on investment securities. The decline in interest on loans was mostly related to a decline in average loans outstanding. Interest on investments securities declined related to a decrease in both yield and average balance. Partially offsetting these decreases in interest income was a decline in rates paid on the Company's deposits and a decline in the average balance of time deposits, interest bearing demand deposits and long-term borrowings.

Interest income decreased \$2.0 million, or 9.7%, to \$18.7 million for the year ended December 31, 2011. Interest and fees on loans decreased by \$1.5 million from \$18.9 million for the year ended December 31, 2010 to \$17.4 million for 2011. The average loan balances were \$302.8 million for 2011, down \$21.1 million from the \$323.9 million for 2010. This decline in loans was mostly related to normal pay downs and prepayments, loan charge-offs, real estate acquired through foreclosure and our on-going efforts to reduce the level of construction and land development loan balances. The average yields on loans were 5.75% for 2011 down from the 5.82% for 2010.

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Interest on investment securities decreased by \$628 thousand resulting from a decrease in yield of 63 basis points and a decline in average investment securities of \$9.9 million. The decline in yield is primarily related to the replacement of matured and sold investment securities with new investments with market yields below those which they replaced.

Interest income on other interest-earning assets, which totaled \$124 thousand in 2011 and \$48 thousand in 2010, relates to interest on cash balances held at the Federal Reserve.

Interest expense on deposits decreased by \$1.2 million, or 46%, to \$1.5 million for the twelve months ended December 31, 2011, down from \$2.7 million in 2011. This decrease primarily relates to decreases in the average balance and rate paid on time deposits and a decline in the rate paid on demand deposit (NOW) and money market accounts.

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Interest on time deposits declined by \$946 thousand. Average time deposits declined by \$27.8 million from \$124.8 million during 2010 to \$97.0 million for the year ended December 31, 2011. The decrease in time deposits is mostly related to a promotional time deposit product we began offering in June, 2009 and continued to offer until April 30, 2010. These promotional time deposits have now fully matured. The average rate paid on these promotional deposits during 2011 was 2%. The average rate paid on time deposits decreased from 1.61% during 2010 to 1.09% during the current twelve month period. This decrease primarily relates to a decline in market rates paid in the Company's service area and the maturity of the higher rate promotional deposits.

Interest expense on NOW accounts declined by \$195 thousand. Rates paid on NOW accounts declined by 18 basis points from 0.38% during 2010 to 0.20% during 2011, as we significantly lowered the rate paid on local public agencies NOW accounts. Although we lost deposits by lowering this rate; we continue to focus on the profitability of the public sweep accounts rather than growing public sweep balances.

Interest expense on money market accounts decreased by \$106 thousand related primarily to a decrease in rate paid on these accounts of 23 basis points from 0.52% during 2010 to 0.29% during 2011. This was primarily related to a significant drop in the rates paid on our money market sweep product. We no longer offer the money market sweep account having replaced it with a product that utilizes repurchase agreements during the third quarter of 2011.

Interest on FHLB long term borrowings decreased by \$130 thousand as there were no outstanding long term borrowings during 2011. Interest expense on junior subordinated debentures, which increased by \$14 thousand from 2010, fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate.

Interest on other borrowings in 2011 primarily relates to interest paid on repurchase agreements.

Net interest margin is net interest income expressed as a percentage of average interest-earning assets. As a result of the changes noted above, the net interest margin for 2011 decreased 16 basis points to 4.08%, from 4.24% for 2010.

2010 compared to 2009. Net interest income, on a nontax-equivalent basis, was \$17.5 million for the year ended December 31, 2010, a decline of \$1.6 million, or 8.6%, from \$19.2 million for 2009.

The overall change in net interest income was primarily a result of a decrease of \$1.8 million in loan interest income, due to a decline in average loans outstanding. Additionally, interest on investments securities declined by \$391 thousand, related to a decrease in yield. Partially offsetting these decreases in interest income was a decline in rates paid on the Company's deposits and borrowings.

Interest income decreased \$2.2 million, or 9.4%, to \$20.7 million for the year ended December 31, 2010. Interest and fees on loans decreased by \$1.8 million from \$20.7 million for the year ended December 31, 2009 to \$18.9 million for 2010. The average loan balances were \$323.9 million for 2010, down \$30.6 million from the \$354.5 million for 2009. The decline in loan balances is consistent with the decrease in economic activity in the Company's service area and the Company's successful effort to reduce its exposure to real estate construction and land development loans. The average yields on loans were 5.82% for 2010 as compared to the 5.83% for 2009.

Interest on investment securities decreased by \$391 thousand, as a decrease in yield of 83 basis points was partially offset by an increase in average investment securities of \$5.3 million. The decline in yield is primarily related to the replacement of matured and sold investment securities with new investments with market yields below those which they replaced.

Deposit rates in the Bank's service area continued to decline in 2010 resulting in a decline in interest expense on deposits of \$473 thousand for the year ended December 31, 2010, from \$3.2 million for 2009 to \$2.7 million for the year ended December 31, 2010. All deposit products experienced rate declines in 2010.

Interest expense on NOW accounts decreased by \$289 thousand related to a decrease in the average rate paid on these accounts. Rates paid on NOW accounts declined by 30 basis points from 0.68% during 2009 to 0.38% during 2010 as we significantly lowered the rate paid on local public agencies NOW accounts. Although we lost some deposits by lowering this rate; we currently are more focused on the profitability of the public sweep accounts rather than the amount of deposits we can generate from this source.

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Interest expense on money market accounts decreased by \$125 thousand related to a decrease in rate paid on these accounts of 31 basis points from 0.83% during the year ended December 31, 2009 to 0.52% during 2010. This was primarily related to a significantly drop in the rates paid on our money market sweep product.

Interest on time deposits declined by \$55 thousand as an increase in average balance was offset by a decline in rate paid. For the year ended December 31, 2010 compared to 2009, the Company's average time deposits increased by \$19.5 million from \$105.3 million for 2009 to \$124.8 million for the year ended December 31, 2010. The increase in time deposits is related to a promotional time deposit product we began offering in June, 2009 and continued to offer until April 30, 2010. The average rate paid on time deposits decreased from 1.96% during 2009 to 1.61% during 2010. This decrease primarily relates to a decline in market rates in the Company's service area.

Interest on borrowings increased by \$28 thousand related to an increase in the rate paid on borrowings as we chose to extend the term of our borrowings; however, this was partially offset by a \$59 thousand decline in interest paid on junior subordinated debentures.

Interest expense on FHLB long-term borrowings increased by \$103 thousand to \$130 thousand for the year ended December 31, 2010. We chose to prepay these borrowings during July 2010 as we had significant excess liquidity and no longer projected a need for these long-term borrowings. We incurred a \$226 thousand prepayment penalty on these advances which we anticipate will be more than offset by future savings in interest expense. Interest on short-term borrowings decreased by \$75 thousand to \$5 thousand related to a decline in average balance of \$23.3 million from \$24.3 million during 2009 to \$986 thousand during 2010.

Interest expense on junior subordinated debentures, which fluctuates with changes in the 3-month London Interbank Offered Rate (LIBOR) rate, decreased by \$59 thousand during 2010 as a result of a decrease in the LIBOR rate.

Net interest margin is net interest income expressed as a percentage of average interest-earning assets. As a result of the changes noted above, the net interest margin for 2010 decreased 28 basis points to 4.24%, from 4.52% for 2009.

Provision for Loan Losses

During the year ended December 31, 2011 we recorded a provision for loan losses of \$3.5 million down \$2.0 million from the \$5.5 million provision recorded during 2010. See [Analysis of Asset Quality and Allowance for Loan Losses](#) for further discussion of loan quality trends and the provision for loan losses.

The allowance for loan losses is maintained at a level that management believes will be appropriate to absorb inherent losses on existing loans based on an evaluation of the collectibility of the loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to repay their loan. The allowance for loan losses is based on estimates, and ultimate losses may vary from the current estimates. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

Based on information currently available, management believes that the allowance for loan losses is appropriate to absorb potential risks in the portfolio. However, no assurance can be given that the Company may not sustain charge-offs which are in excess of the allowance in any given period.

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The following table sets forth the components of non-interest income for the years ended December 31, 2011, 2010 and 2009.

	September 30, 2011	September 30, Years Ended December 31, 2010	September 30, 2009	September 30, Change during Year 2011	September 30, 2010
	(dollars in thousands)				
Service charges on deposit accounts	\$ 3,477	\$ 3,642	\$ 3,796	\$ (165)	\$ (154)
Gain on sale of loans, net	1,939	1,055	593	884	462
Gain on sale of investments	666	1,160	10	(494)	1,150
Earnings on bank owned life insurance policies	352	351	346	1	5
Loan servicing fees	219	195	139	24	56
Customer service fees	141	135	121	6	14
Safe deposit box and night depository income	66	66	68		(2)
Merchant processing	15	141	282	(126)	(141)
Sale of merchant processing portfolio		1,435		(1,435)	1,435
Other income	287	288	309	(1)	(21)
Total non-interest income	\$ 7,162	\$ 8,468	\$ 5,664	\$ (1,306)	\$ 2,804

2011 compared to 2010. During the year ended December 31, 2011 non-interest income decreased by \$1.3 million to \$7.2 million, from \$8.5 million during the year ended December 31, 2010. This decrease was related to the sale of our merchant processing portfolio in 2010. During June 2010 we entered into an alliance with a world-wide merchant processing leader. In conjunction with this alliance we sold our merchant processing business, recording a one-time gain of \$1.4 million. Related to this sale we experienced a decrease in merchant processing income of \$126 thousand during the comparison periods. Service charges on deposit accounts declined by \$165 thousand primarily related to a decline in overdraft fees as new regulations placed additional restrictions on the Bank in charging overdraft fees on ATM and Point of Sale transactions. Gain on sale of investments declined by \$494 thousand. During the year ended December 31, 2011 we sold twenty-seven investment securities classified as available-for-sale for \$29.4 million recognizing a \$0.7 million gain on sale. During the 2010 period we sold sixty-five investment securities classified as available-for sale for \$40.9 million and recorded a \$1.2 million gain on sale. We chose to sell some of the securities in our investment portfolio in order to lock in gains; this had the additional benefit of partially offsetting some nonrecurring expense items such as losses on sale of OREO.

Partially offsetting these declines in income was a \$884 thousand increase in gain on sale of government guaranteed loans. Gains on sale in 2011 were particularly strong related to two factors. First, during the first quarter of 2011 the SBA eliminated the recourse provision related to loan sales allowing us to record both gains on sales from loans sold during the fourth quarter of 2010 and the first quarter of 2011. In addition, many loans sold in 2011 were 90% guaranteed related to a temporary increase in guarantee percentage enacted on February 17, 2009 as part of the Recovery Act. Currently loans made through the SBA 7(a) program carry a 75% to 85% guarantee. The production and sale of government guaranteed loans has become an important component of the Company's core business. We expect government guaranteed lending activity to remain strong in 2012; however, we anticipate a reduction in gains on sale during 2012.

Loan servicing fees increased by \$24 thousand to \$219 thousand for the year ended December 31, 2011. Loan servicing fees are primarily related to fees earned for servicing the sold portion of SBA loans and the increase in this category is consistent with the increase in sold SBA loans.

2010 compared to 2009. During the year ended December 31, 2010 non-interest income increased by \$2.8 million to \$8.6 million, from \$5.8 million during 2009. This increase was primarily related to three items, the largest of which was a \$1.4 million gain on the sale of our merchant processing portfolio. Additionally we sold securities having a book value of \$39.7 million, recording a gain on sale of \$1.2 million. We chose to sell substantially our entire municipal securities portfolio as part of our overall asset/liability management strategy and related to the favorable market price for these securities. In addition, we sold \$28.9 million in U.S. government agency securities to lock in significant gains that were available on these securities. Finally, we recorded a gain on sale of government guaranteed loans of \$1.1 million representing the sale of \$13.6 million in loans. Additional SBA government guaranteed loans totaling \$4.3 million were sold during the fourth quarter; however, the gain on

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sale generated was not recorded until the 90-day premium recourse period on SBA loan sales had expired. During the first quarter of 2011, the Company recognized a gain on sale of approximately \$338 thousand related to loans sold during the fourth quarter of 2010; however, this gain was partially offset by commission expense of approximately \$106 thousand.

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Loan servicing fees increased by \$56 thousand to \$195 thousand for the year ended December 31, 2010. Loan servicing fees are primarily related to fees earned for servicing the sold portion of SBA loans and the increase in this category is consistent with the increase in sold SBA loans.

Service charges on deposit accounts declined by \$154 thousand primarily related to a decline in overdraft fees as new regulations placed additional restrictions on the Bank in charging overdraft fees on ATM and Point of Sale transactions. Merchant processing fees declined by \$141 thousand related to the sale of our merchant processing portfolio in June, 2010.

Non-Interest Expense

The following table sets forth the components of other non-interest expense for the years ended December 31, 2011, 2010 and 2009.

	September 30, Years Ended December 31,			September 30, Change during Year	
	2011	2010	2009	2011	2010
	(dollars in thousands)				
Salaries and employee benefits	\$ 9,195	\$ 9,732	\$ 11,054	\$ (537)	\$ (1,322)
Occupancy and equipment	3,088	3,096	3,759	(8)	(663)
Outside service fees	1,270	1,212	990	58	222
FDIC insurance	1,099	1,009	1,125	90	(116)
Professional fees	730	587	789	143	(202)
Loss (gain) on sale of OREO	606	(43)	158	649	(201)
Provision for OREO losses	579	356	4,800	223	(4,444)
OREO costs	422	573	370	(151)	203
Telephone and data communications	331	338	392	(7)	(54)
Business development	262	250	333	12	(83)
Loan collection costs	261	261	399		(138)
Advertising and promotion	236	252	327	(16)	(75)
Director compensation and retirement	229	233	293	(4)	(60)
Armored car and courier	225	239	281	(14)	(42)
Postage	190	207	207	(17)	
Core deposit intangible	173	173	173		
Stationery and supplies	140	145	183	(5)	(38)
Insurance	42	125	54	(83)	71
Other operating expense	168	396	579	(228)	(183)
Total non-interest expense	\$ 19,246	\$ 19,141	\$ 26,266	\$ 105	\$ (7,125)

2011 compared to 2010. While we have achieved savings in many categories of non-interest expense these were offset in the current year by an increase of \$649 thousand in loss on sale of OREO. Non-interest expense increased by \$105 thousand from \$19.1 million during the year ended December 31, 2010 to \$19.2 million during the current twelve month period.

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OREO represents real property taken by the Bank either through foreclosure or through a deed in lieu thereof from the borrower. Loss on sale of OREO totaled \$606 thousand primarily related to the sale of one property. During June, 2011 the Bank sold its largest OREO holding which represented \$4.3 million, or 48% of the total balance in OREO at January 1, 2011. The Bank incurred a \$617 thousand loss on sale; however, management believes the loss was prudent given the significant affect this transaction had in decreasing nonperforming assets.

Outside service fees increased by \$58 thousand which mostly relates to our on-line banking and bill payment platform. FDIC insurance costs increased related to an increase in the rate the FDIC charges Plumas Bank. Professional fees increased by \$143 thousand the largest portion of which was related to an increase in consulting cost of \$97 thousand. During the second half of 2011 we contracted with an outside party to provide assistance in the management of our nonperforming assets. Total costs incurred related to this consultant were \$42 thousand. In addition we incurred \$21 thousand in costs related to an outside management study required by the Consent Order.

The largest reduction in expense was a decrease of \$537 thousand in salaries and employee benefits. Salary expense, excluding commissions, declined by \$667 thousand mostly related to a reduction in staffing, during the second quarter of 2010, which affected most functional areas with the exception of government guaranteed lending and problem assets. On a full-time equivalent basis, we employed 142 persons at December 31, 2011 down from 146 at December 31, 2010 and 163 at December 31, 2009. Commission expense, which relates to government guaranteed lending personnel and is included in salary expense, increased by \$318 thousand resulting from the increase in government guaranteed loan gains.

The provision for OREO losses increased by \$223 thousand related to one land development property that, based on a recent appraisal, declined in value by \$417 thousand. This property is currently valued at approximately \$1 million. OREO carrying costs declined by \$151 thousand from \$573 thousand during 2010 to \$422 thousand during 2011. These savings were primarily related to property taxes on OREO properties and refunds on prior year tax payments related to some of our OREO properties being reassessed.

Insurance expense declined by \$83 thousand primarily related to the forfeiture of retirement split dollar life insurance benefits by one of our executive officers who chose to terminate his employment during 2011 prior to age sixty-five.

Other non-interest expense declined by \$228 thousand related to a \$226 thousand prepayment penalty incurred upon the prepayment of our long-term Federal Home Loan Bank borrowings during July, 2010.

2010 compared to 2009. During the second quarter of 2010 we performed an extensive analysis of our personnel requirements throughout the organization and based on this analysis we were able to reduce our head count by approximately 10% which resulted in significant savings in salary and benefits during the second half of 2010. During the year ended December 31, 2010, total non-interest expense decreased by \$7.1 million, or 27%, to \$19.2 million, down from \$26.3 million for the comparable period in 2009. This decrease in non-interest expense was primarily the result of savings in salaries and employee benefits, occupancy and equipment costs, professional fees, provision for OREO losses and a reduction in losses on the sale of OREO. These items and other reductions were partially offset by increases in outside service fees, OREO carrying expenses and insurance expense.

Salaries and employee benefits decreased by \$1.3 million primarily related to four items. Salary expense, excluding commissions, declined by \$796 thousand related to a reduction in staffing in all areas with the exception of government guaranteed lending and problem assets. While the Company reduced personnel in most functional areas, we increased staffing in our problem asset department to effectively manage our increased level of nonperforming assets. Additionally, staffing in our government guaranteed lending department was increased to support opportunities for loan growth in this area. Commission expense, which relates to government guaranteed lending personnel and is included in salary expense, increased by \$152 thousand resulting from the increase in government guaranteed loan sales. Stock compensation expense decreased by \$199 thousand. During the first quarter of 2010 we recorded an adjustment to the estimated forfeiture rate associated with option expense. Finally, we eliminated discretionary bonuses in 2010 resulting in a decrease in bonus expense of \$269 thousand and during the second quarter of 2010 we discontinued the Company matching contributions to our 401k plan saving \$172 thousand during 2010.

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The decline in occupancy and equipment expense primarily relates to the savings realized from the purchase of our Redding branch. On March 31, 2010 we purchased the building housing our Redding branch at a cost of \$1.0 million. Previously we had leased this building. Under the terms of the lease agreement we were provided free rent for a period of time; however, in accordance with accounting principals we recognized monthly rent expense equal to the total payments required under the lease dividend by the term of the lease in months. At the time of the purchase we reversed this accrual recognizing a \$184 thousand reduction in occupancy costs. In addition to the one-time savings from the reversal of accrued rent we benefit from reduced operating costs on this building as the owner rather than a renter. Occupancy costs also benefited from a milder winter resulting in reduced utility and snow removal costs. Equipment costs benefited from a \$153 thousand reduction in depreciation expense.

Professional fees were abnormally high during 2009 related to consulting costs associated with our computer network and telephone system. The decrease in profession fees includes a \$157 thousand reduction in consulting costs.

Losses on the sale of OREO totaled \$158 thousand during 2009; however, during 2010 we recorded \$43 thousand net gains on sale of OREO. During 2009 we experienced a significant decline in the value of many of our OREO properties requiring a \$4.8 million loss provision; however, this decline in value slowed significantly in 2010. During 2010 our provision for OREO losses declined by \$4.4 million to \$356 thousand.

Other reductions in expense include savings in FDIC insurance, telephone, loan collection costs, business development, advertising, director expense, courier expense, director expenses, supplies costs and other. In total these costs were down \$789 thousand for 2010.

Outside service fees increased by \$222 thousand related to the outsourcing of daily management of our computer network operations and the installation of a new internet banking platform. Consistent with the increase in average OREO (See Analysis of Asset Quality and Allowance for Loan Losses) OREO carrying expenses increased by \$203 thousand.

Insurance expense was abnormally low in 2009. During the first quarter of 2009 our Chief Information and Technology officer retired from the Company. Because his retirement took place prior to the age of sixty-five he forfeited his benefits under his company provided split dollar life insurance plan. To reflect this forfeiture we recorded a one-time reduction in insurance expense totaling \$83 thousand.

Provision for Income Taxes. The Company recorded an income tax provision of \$295 thousand, or 23.9% of pre-tax income for the year ended December 31, 2011. During 2010 the Company recorded an income tax provision of \$389 thousand, or 28.6% of pre-tax income for the year ended December 31, 2010. The percentages for 2011 and 2010 differ from the statutory rate as tax exempt income such as earnings on Bank owned life insurance, municipal loan interest, and in the state of California enterprise zone interest decrease taxable income.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The determination of the amount of deferred income tax assets which are more likely than not to be realized is primarily dependent on projections of future earnings, which are subject to uncertainty and estimates that may change given economic conditions and other factors. The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is more likely than not that all or a portion of the deferred tax asset will not be realized. More likely than not is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed.

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As part of its analysis, the Company considered the following positive evidence:

The Company's 2009 net loss was largely attributable to losses on its Construction and Land Development portfolio that represented approximately 80% of net charge-offs during the year ended December 31, 2009. This portfolio has decreased from \$74 million at December 31, 2008 to \$17 million at December 31 2011.

The Company's 2009 net loss was also attributable to significant write-downs on foreclosed construction and land development real estate properties which represented the majority of its provision for losses on other real estate during 2009. During 2010 other real estate write-downs decreased by \$4.4 million from \$4.8 million during the year ended December 31, 2009 to \$356 thousand during 2010. Write-downs on construction and land development real estate owned during 2011 totaled \$440 thousand.

The Company has a long history of earnings and profitability.

The Company was profitable in 2011 and 2010 and is projecting future taxable and book income will be generated by operations.

The size of loans in the Company's pipeline of potential problem loans has significantly decreased.

The Company does not have a history of net operating losses carry forwards or tax credits expiring unused.

As part of its analysis, the Company also considered the following negative evidence:

The Company recorded a large net loss in 2009 and is in a cumulative loss position for the current and preceding two years. Based upon the analysis of available evidence, management has determined that it is more likely than not that all deferred income tax assets as of December 31, 2011 and 2010 will be fully realized and therefore no valuation allowance was recorded.

Financial Condition

Loan Portfolio. The Company continues to manage the mix of its loan portfolio consistent with its identity as a community bank serving the financing needs of all sectors of the area it serves. Although the Company offers a broad array of financing options, it continues to concentrate its focus on small to medium sized commercial businesses. These commercial loans offer diversification as to industries and types of businesses, thus limiting material exposure in any industry concentrations. The Company offers both fixed and floating rate loans and obtains collateral in the form of real property, business assets and deposit accounts, but looks to business and personal cash flows as its primary source of repayment.

The Company's largest lending categories are commercial real estate loans, residential real estate loans, and agricultural loans. These categories accounted for approximately 40.6%, 13.3% and 13.2%, respectively of the Company's total loan portfolio at December 31, 2011, and approximately 37.9%, 13.8% and 12.2%, respectively of the Company's total loan portfolio at December 31, 2010. Construction and land development loans continue to decline and represented 5.8% and 9.9% of the loan portfolio as of December 31, 2011 and December 31, 2010, respectively. The construction and land development portfolio component has been identified by Management as a higher-risk loan category. The quality of the construction and land development category is highly dependent on property values both in terms of the likelihood of repayment once the property is transacted by the current owner as well as the level of collateral the Company has securing the loan in the event of default. Loans in this category are characterized by the speculative nature of commercial and residential development properties and can include property in various stages of development from raw land to finished lots. The decline in these loans as a percentage of the Company's loan portfolio reflects management's continued efforts, which began in 2009, to reduce its exposure to construction and land development loans due to the severe valuation decrease in the real estate market.

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The Company's real estate related loans, including real estate mortgage loans, real estate construction loans, consumer equity lines of credit, and agricultural loans secured by real estate comprised 81% and 80% of the total loan portfolio at December 31, 2011 and December 31, 2010, respectively. Moreover, the business activities of the Company currently are focused in the California counties of Plumas, Nevada, Placer, Lassen, Modoc, Shasta, Sierra and in Washoe County in Northern Nevada. Consequently, the results of operations and financial condition of the Company are dependent upon the general trends in these economies and, in particular, the residential and commercial real estate markets. In addition, the concentration of the Company's operations in these areas of Northeastern California and Northwestern Nevada exposes it to greater risk than other banking companies with a wider geographic base in the event of catastrophes, such as earthquakes, fires and floods in these regions.

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The rates of interest charged on variable rate loans are set at specific increments in relation to the Company's lending rate or other indexes such as the published prime interest rate or U.S. Treasury rates and vary with changes in these indexes. At December 31, 2011 and December 31, 2010, approximately 73% and 66%, respectively, of the Company's loan portfolio was comprised of variable rate loans. While real estate mortgage, commercial and consumer lending remain the foundation of the Company's historical loan mix, some changes in the mix have occurred due to the changing economic environment and the resulting change in demand for certain loan types. In addition, the Company remains committed to the agricultural industry in Northeastern California and will continue to pursue high quality agricultural loans. Agricultural loans include both commercial and commercial real estate loans. The Company's agricultural loan balances totaled \$39 million at December 31, 2011 and \$38 million at December 31, 2010.

The following table sets forth the amounts of loans outstanding by category as of the dates indicated.

	September 30, 2011	September 30, 2010	September 30, At December 31, 2009 (dollars in thousands)	September 30, 2008	September 30, 2007
Real estate mortgage	\$ 158,431	\$ 162,513	\$ 161,397	\$ 151,943	\$ 128,357
Real estate construction and land development	17,063	31,199	38,061	73,820	76,478
Commercial	30,235	33,433	37,056	42,528	39,584
Consumer (1)	49,268	48,586	54,442	61,706	72,768
Agriculture (2)	38,868	38,469	41,722	36,020	35,762
Total loans	293,865	314,200	332,678	366,017	352,949
Less:					
Deferred costs	(475)	(275)	(298)	(279)	(564)
Allowance for loan losses	6,908	7,324	9,568	7,224	4,211
Net loans	\$ 287,432	\$ 307,151	\$ 323,408	\$ 359,072	\$ 349,302

(1) Includes equity lines of credit

(2) Includes agriculture real estate

The following table sets forth the maturity of gross loan categories as of December 31, 2011. Also provided with respect to such loans are the amounts due after one year, classified according to sensitivity to changes in interest rates:

	September 30, Within One Year	September 30, After One Through Five Years	September 30, After Five Years	September 30, Total
	(dollars in thousands)			
Real estate mortgage	\$ 10,357	\$ 39,933	\$ 108,141	\$ 158,431
Real estate construction and land development	6,811	7,237	3,015	17,063
Commercial	9,744	16,005	4,486	30,235
Consumer	5,644	12,044	31,580	49,268
Agriculture	13,758	10,018	15,092	38,868
Total	\$ 46,314	\$ 85,237	\$ 162,314	\$ 293,865

Loans maturing after one year with:

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Fixed interest rates	\$	26,275	\$	42,419	\$	68,694
Variable interest rates		58,962		119,899		178,861
 Total		 \$ 85,237		 \$ 162,318		 \$ 247,555

Analysis of Asset Quality and Allowance for Loan Losses. The Company attempts to minimize credit risk through its underwriting and credit review policies. The Company's credit review process includes internally prepared credit reviews as well as contracting with an outside firm to conduct periodic credit reviews. The Company's management and lending officers evaluate the loss exposure of classified and impaired loans on a quarterly basis, or more frequently as loan conditions change. The Management Asset Resolution Committee (MARC) reviews the asset quality of criticized loans on a monthly basis and reports the findings to the full Board of Directors. The Board's Loan Committee reviews the asset quality of new loans on a monthly basis and reports the findings to the full Board of Directors. In management's opinion, this loan review system helps facilitate the early identification of potential criticized loans.

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The Company has implemented MARC to develop an action plan to significantly reduce nonperforming loans. It consists of members of executive management and credit administration management, and the activities are governed by a formal written charter. The MARC meets at least monthly and reports to the Board of Directors.

More specifically, a formal plan to effect repayment and/or disposition of every significant nonperforming loan relationship is developed and documented for review and on-going oversight by the MARC. Some of the strategies used include but are not limited to: 1) obtaining additional collateral, 2) obtaining additional investor cash infusion, 3) sale of the promissory note to an outside party, 4) proceeding with foreclosure on the underlying collateral, 5) legal action against borrower/guarantors to encourage settlement of debt and/or collect any deficiency balance owed. Each step includes a benchmark timeline to track progress.

MARC also provides guidance for the maintenance and timely disposition of OREO properties; including developing financing and marketing programs to incent individuals to purchase OREO.

The allowance for loan losses is established through charges to earnings in the form of the provision for loan losses. Loan losses are charged to and recoveries are credited to the allowance for loan losses. The allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent risks in loans. The adequacy of the allowance for loan losses is based upon management's continuing assessment of various factors affecting the collectibility of loans; including current economic conditions, maturity of the portfolio, size of the portfolio, industry concentrations, borrower credit history, collateral, the existing allowance for loan losses, independent credit reviews, current charges and recoveries to the allowance for loan losses and the overall quality of the portfolio as determined by management, regulatory agencies, and independent credit review consultants retained by the Company. There is no precise method of predicting specific losses or amounts which may ultimately be charged off on particular segments of the loan portfolio. The collectibility of a loan is subjective to some degree, but must relate to the borrower's financial condition, cash flow, quality of the borrower's management expertise, collateral and guarantees, and state of the local economy.

The federal financial regulatory agencies in December 2006 issued a new interagency policy statement on the allowance for loan and lease losses along with supplemental frequently asked questions. When determining the adequacy of the allowance for loan losses, the Company follows these guidelines. The policy statement revises and replaces a 1993 policy statement on the allowance for loan and lease losses. The agencies issued the revised policy statement in view of today's uncertain economic environment and the presence of concentrations in untested loan products in the loan portfolios of insured depository institutions. The policy statement was also revised to conform with accounting principles generally accepted in the United States of America (GAAP) and post-1993 supervisory guidance. The policy statement reiterates that each institution has a responsibility for developing, maintaining and documenting a comprehensive, systematic, and consistently applied process appropriate to its size and the nature, scope, and risk of its lending activities for determining the amounts of the allowance for loan and lease losses and the provision for loan and lease losses and states that each institution should ensure controls are in place to consistently determine the allowance for loan and lease losses in accordance with GAAP, the institution's stated policies and procedures, management's best judgment and relevant supervisory guidance.

The policy statement also restates that insured depository institutions must maintain an allowance for loan and lease losses at a level that is appropriate to cover estimated credit losses on individually evaluated loans determined to be impaired as well as estimated credit losses inherent in the remainder of the loan and lease portfolio, and that estimates of credit losses should reflect consideration of all significant factors that affect the collectibility of the portfolio as of the evaluation date. The policy statement states that prudent, conservative, but not excessive, loan loss allowances that represent management's best estimate from within an acceptable range of estimated losses are appropriate. In addition, the Company incorporates the Securities and Exchange Commission Staff Accounting Bulletin No. 102, which represents the SEC staff's view related to methodologies and supporting documentation for the Allowance for Loan and Lease Losses that should be observed by all public companies in complying with the federal securities laws and the Commission's interpretations.

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The Company's methodology for assessing the adequacy of the allowance for loan losses consists of several key elements, which include but are not limited to:

specific allocation determined in accordance with ASC Topic 310 – Receivables, based on probable losses on specific loans.

general reserves determined in accordance with guidance in ASC Topic 450 – Contingencies, based on historical loan loss experience adjusted for other qualitative risk factors both internal and external to the Company.

Specific allocations are established based on management's periodic evaluation of loss exposure inherent in classified, impaired, and other loans in which management believes that the collection of principal and interest under the original contractual terms of the loan agreement are in question. For purposes of this analysis, loans are grouped by internal risk classifications which are watch, substandard, doubtful, and loss. Watch loans are currently performing but are potentially weak, as the borrower has begun to exhibit deteriorating trends, which if not corrected, could jeopardize repayment of the loan and result in further downgrade. Substandard loans have well-defined weaknesses which, if not corrected, could jeopardize the full satisfaction of the debt. A loan classified as doubtful has critical weaknesses that make full collection of the obligation improbable. Classified loans, as defined by the Company, include loans categorized as substandard and doubtful. Loans classified as loss are immediately charged off.

Loans are consistently monitored against risk rating criteria. As loans are identified that may warrant a classification change, they are discussed with the Company's credit administration officers and appropriate risk grades are assigned. There are several times in the life of a loan that this occurs:

loan origination

loan renewal

loan servicing actions (change in terms, collateral release, etc.)

annual financial review

delinquency monitoring and follow-up

loan review process

audit process

If weaknesses (or improvements) are noted, a change in risk rating, if warranted by credit administration, will be made. Loans classified Watch or below in an amount of \$100,000 or more will be individually evaluated for impairment in accordance with the Bank's policy for determining and measuring impairment.

Formula allocations are calculated by applying loss factors to outstanding loans with similar characteristics. Loss factors are based on the Company's historical loss experience as adjusted for changes in the business cycle and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date. Effective for the third quarter of 2010, the Company modified its method of estimating the allowance for loan losses for loans collectively evaluated for impairment. This modification incorporated historical loss experience based on a rolling eight quarters ending with the most recently completed calendar quarter to identified pools of loans. This modification did not have a material affect on the Company's allowance for loans losses or provision for loan losses. No modifications to

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the allowance for loan losses methodology were made in 2011.

The discretionary allocation is based upon management's evaluation of various loan segment conditions that are not directly measured in the determination of the formula and specific allowances. The conditions may include, but are not limited to, general economic and business conditions affecting the key lending areas of the Company, credit quality trends, collateral values, loan volumes and concentrations, and other business conditions.

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The following table provides certain information for the years indicated with respect to the Company's allowance for loan losses as well as charge-off and recovery activity.

	September 30, 2011	September 30, 2010	September 30, 2009	September 30, 2008	September 30, 2007
	For the Year Ended December 31, (dollars in thousands)				
Balance at beginning of period	\$ 7,324	\$ 9,568	\$ 7,224	\$ 4,211	\$ 3,917
Charge-offs:					
Commercial and agricultural	539	1,219	663	477	83
Real estate mortgage	483	3,105	1,145	95	
Real estate construction	2,603	3,617	10,133	522	46
Consumer	622	408	559	689	657
Total charge-offs	4,247	8,349	12,500	1,783	786
Recoveries:					
Commercial and agricultural	199	26	18	11	53
Real estate mortgage	18	396	8	14	
Real estate construction	5	65	90		
Consumer	109	118	228	171	227
Total recoveries	331	605	344	196	280
Net charge-offs	3,916	7,744	12,156	1,587	506
Provision for loan losses	3,500	5,500	14,500	4,600	800
Balance at end of period	\$ 6,908	\$ 7,324	\$ 9,568	\$ 7,224	\$ 4,211
Net charge-offs during the period to average loans	1.29%	2.39%	3.43%	0.45%	0.14%
Allowance for loan losses to total loans	2.35%	2.33%	2.88%	1.97%	1.19%

During the year ended December 31, 2011 we recorded a provision for loan losses of \$3.5 million down \$2.0 million from the \$5.5 million provision recorded during the year ended December 31, 2010. Net charge-offs totaled \$3.9 million during the year ended December 31, 2011 and \$7.7 million during 2010. Net charge-offs as a percentage of average loans decreased from 2.39% during 2010 to 1.29% during the year ended December 31, 2011.

The following table provides a breakdown of the allowance for loan losses:

	September 30, Balance at End of Period 2011	September 30, Percent of Loans in Each Category to Total Loans 2011	September 30, Balance at End of Period 2010	September 30, Percent of Loans in Each Category to Total Loans 2010
Commercial and agricultural	1,355	23.5%	944	22.9%
Real estate mortgage	2,623	53.9%	2,451	51.7%
Real estate construction	2,006	5.8%	3,011	9.9%
Consumer (includes equity LOC)	924	16.8%	918	15.5%

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Total	6,908	100.0%	7,324	100.0%
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The allowance for loan losses totaled \$6.9 million at December 31, 2011 and \$7.3 million at December 31, 2010. Specific reserves related to impaired loans increased from \$1.9 million at December 31, 2010 to \$2.1 million at December 31, 2011. At least quarterly the Company evaluates each specific reserve and if it determines that the loss represented by the specific reserve is uncollectable it reverses the specific reserve and takes a partial charge-off in its place. General reserves decreased by \$579 thousand to \$4.8 million at December 31, 2011. The allowance for loan losses as a percentage of total loans increased slightly from 2.33% at December 31, 2010 to 2.35% at December 31, 2011. The percentage of general reserves to unimpaired loans decreased from 1.90% at December 31, 2010 to 1.80% at December 31, 2011 primarily related to a decrease in charge-offs during the eight quarters ending December 31, 2011 as compared to the eight quarters ended December 31, 2010 which resulted in a lower loss rate applied to unimpaired loans.

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The Company places loans 90 days or more past due on nonaccrual status unless the loan is well secured and in the process of collection. A loan is considered to be in the process of collection if, based on a probable specific event, it is expected that the loan will be repaid or brought current. Generally, this collection period would not exceed 90 days. When a loan is placed on nonaccrual status the Company's general policy is to reverse and charge against current income previously accrued but unpaid interest. Interest income on such loans is subsequently recognized only to the extent that cash is received and future collection of principal is deemed by management to be probable. Where the collectibility of the principal or interest on a loan is considered to be doubtful by management, it is placed on nonaccrual status prior to becoming 90 days delinquent.

Impaired loans are measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. The amount of impaired loans is not directly comparable to the amount of nonperforming loans disclosed later in this section. The primary difference between impaired loans and nonperforming loans is that impaired loan recognition considers not only loans 90 days or more past due, restructured loans and nonaccrual loans but also may include identified problem loans other than delinquent loans where it is considered probable that we will not collect all amounts due to us (including both principal and interest) in accordance with the contractual terms of the loan agreement.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

Loans restructured and in compliance with modified terms totaled \$8.4 million, \$2.0 million and \$3.4 million at December 31, 2011, 2010 and 2009, respectively. There were no troubled debt restructurings at December 31, 2008, or 2007. For additional information related to restructured loans see Note 6 of the Company's Consolidated Financial Statements in Item 8 Financial Statements and Supplementary Data of this Annual Report on Form 10K.

The following table sets forth the amount of the Company's nonperforming assets as of the dates indicated.

	September 30, 2011	September 30, 2010	September 30, At December 31, 2009 (dollars in thousands)	September 30, 2008	September 30, 2007
Nonaccrual loans	\$ 16,757	\$ 25,313	\$ 14,263	\$ 26,444	\$ 2,618
Loans past due 90 days or more and still accruing	72	45	28	297	14
Total nonperforming loans	16,829	25,358	14,291	26,741	2,632
Other real estate owned	8,623	8,867	11,204	4,148	402
Other vehicles owned	57	17	65	129	135
Total nonperforming assets	\$ 25,509	\$ 34,242	\$ 25,560	\$ 31,018	\$ 3,169
Interest income forgone on nonaccrual loans	\$ 510	\$ 1,021	\$ 568	\$ 576	\$ 161
Interest income recorded on a cash basis on nonaccrual loans	\$ 285	\$ 608	\$ 369	\$ 74	\$ 118
Nonperforming loans to total loans	5.73%	8.07%	4.30%	7.31%	0.75%
Nonperforming assets to total assets	5.60%	7.07%	4.84%	6.78%	0.70%

Nonperforming loans at December 31, 2011 were \$16.8 million, a decrease of \$8.5 million from the \$25.3 million balance at December 31, 2010. The decline of \$8.5 million includes \$5.7 million in loans transferred to OREO, a \$4.4 million loan that was returned to performing status and charge-offs and principal repayments on nonperforming loans partially offset by \$9.1 million in additional loans placed on nonperforming status during the period. Specific reserves on nonaccrual loans totaled \$1.3 million at December 31, 2011 and \$1.8 million at December 31, 2010, respectively. Performing loans past due thirty to eighty-nine days increased from \$2.9 million at December 31, 2010 to \$5.1 million at December 31, 2011.

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A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Total substandard loans decreased by \$9.4 million from \$38.6 million at December 31, 2010 to \$29.2 million at December 31, 2011. Loans classified as watch decreased as well from \$14.2 million at December 31, 2010 to \$10.7 million at December 31, 2011. At December 31, 2011, \$13.9 million of performing loans were classified as substandard. Further deterioration in the credit quality of individual performing substandard loans or other adverse circumstances could result in the need to place these loans on nonperforming status.

At December 31, 2011 and December 31, 2010, the Company's recorded investment in impaired loans totaled \$24.4 million and \$28.8 million, respectively. The specific allowance for loan losses related to impaired loans totaled \$2.1 million and \$1.9 million at December 31, 2011 and December 31, 2010, respectively. Additionally, \$940 thousand has been charged off against the impaired loans at December 31, 2011 and \$2.8 million at December 31, 2010.

It is the policy of management to make additions to the allowance for loan losses so that it remains appropriate to absorb the inherent risk of loss in the portfolio. Management believes that the allowance at December 31, 2011 is appropriate. However, the determination of the amount of the allowance is judgmental and subject to economic conditions which cannot be predicted with certainty. Accordingly, the Company cannot predict whether charge-offs of loans in excess of the allowance may occur in future periods.

OREO represents real property taken by the Bank either through foreclosure or through a deed in lieu thereof from the borrower. Repossessed assets include vehicles and other commercial assets acquired under agreements with delinquent borrowers. Repossessed assets and OREO are carried at fair market value, less selling costs. OREO holdings represented forty-four properties totaling \$8.6 million at December 31, 2011 and thirty-one properties totaling \$8.9 million at December 31, 2010. During June, 2011 the Bank sold its largest OREO holding which represented \$4.3 million, or 48% of the total balance in OREO at January 1, 2011. The Bank incurred a \$617 thousand loss on sale; however, management believes the loss was prudent given the significant affect this transaction had in decreasing nonperforming assets. Nonperforming assets as a percentage of total assets were 5.60% at December 31, 2011 and 7.07% at December 31, 2010.

The following table provides a summary of the change in the OREO balance for the years ended December 31, 2011 and 2010:

	September 30, Year Ended December 31, 2011	September 30, 2010
	(in thousands)	
Beginning Balance	\$ 8,867	\$ 11,204
Additions	5,825	1,438
Dispositions	(5,490)	(3,419)
Write-downs	(579)	(356)
Ending Balance	\$ 8,623	\$ 8,867

Investment Portfolio and Federal Funds Sold. Total investment securities decreased by \$5.1 million from \$63.0 million at December 31, 2010 to \$57.9 million as of December 31, 2011. While investment securities decreased from December 31, 2010 levels, we anticipate adding to investment securities during the next three months. The investment portfolio at December 31, 2011 was invested entirely in U.S. Government-sponsored agencies, at December 31, 2010 the investment portfolio consisted of 2% U.S. Treasuries and 98% U.S. Government-sponsored agencies. There were no Federal funds sold at December 31, 2011 or 2010; however, the Bank maintained interest earning balances at the Federal Reserve Bank (FRB) totaling \$47.8 million at December 31, 2011 and \$52.3 million at December 31, 2010, respectively. These balances currently earn 25 basis points.

The Company classifies its investment securities as available-for-sale or held-to-maturity. Currently all securities are classified as available-for-sale. Securities classified as available-for-sale may be sold to implement the Company's asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors.

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The following tables summarize the values of the Company's investment securities held on the dates indicated:

Available-for-sale (fair value)	September 30, 2011	September 30, December 31, 2010 (dollars in thousands)	September 30, 2009
U.S. Treasuries	\$	\$ 1,032	\$ 1,052
U.S. Government-sponsored agencies	32,777	40,430	55,889
U.S. Government-sponsored agency residential mortgage-backed securities	25,140	21,273	19,287
Municipal obligations		282	11,722
Total	\$ 57,917	\$ 63,017	\$ 87,950

At December 31, 2009 the Company transferred all of its municipal securities from held-to-maturity to available-for-sale as it was determined that management no longer had the intent to hold these investments to maturity.

The following table summarizes the maturities of the Company's securities at their carrying value and their weighted average tax equivalent yields at December 31, 2011.

(dollars in thousands) Available-for-sale (Fair Value)	0000 After One Through Five Years Amount	0000 Yield	0000 After Five Through Ten Years Amount	0000 Yield	0000 After Ten Years Amount	0000 Yield	0000 Total Amount	0000 Yield
U.S. Government-sponsored agencies	\$ 32,777	1.08%					% \$ 32,777	1.08%
U.S. Government-sponsored agency residential mortgage-backed securities	554	3.84%	\$ 6,395	1.74%	\$ 18,191	2.59%	25,140	2.40%
Total	\$ 33,331	1.12%	\$ 6,395	1.74%	\$ 18,191	2.59%	\$ 57,917	1.65%

Deposits. Total deposits were \$391.1 million as of December 31, 2011, a decrease of \$33.8 million, or 8%, from the December 31, 2010 balance of \$424.9 million. The decline in deposits was mostly related to maturities from a higher rate promotional time deposit product we began offering in June, 2009 and continued to offer until April 30, 2010. Core deposit growth was strong with increases in non-interest bearing deposits of \$14.1 million and an increase in savings accounts of \$10.8 million.

The Company continues to manage the mix of its deposits consistent with its identity as a community bank serving the financial needs of its customers. The deposit mix changed slightly from December 31, 2010 as time deposits decreased and we had an increase in non-interest bearing demand deposits and savings accounts. Non-interest bearing demand deposits were 32% of total deposits at December 31, 2011 and 26% of total deposits at December 31, 2010. Interest bearing transaction accounts were 21% of total deposits at December 31, 2011 and 24% of total deposits at December 31, 2010. Money market and savings deposits totaled 26% of total deposits at December 31, 2011 and 22% at December 31, 2010. Time deposits were 21% of total deposits at December 31, 2011 and 28% of total deposits at December 31, 2010.

Deposits represent the Bank's primary source of funds. Deposits are primarily core deposits in that they are demand, savings and time deposits generated from local businesses and individuals. These sources are considered to be relatively stable, long-term relationships thereby enhancing steady growth of the deposit base without major fluctuations in overall deposit balances. The Company experiences, to a small degree, some seasonality with the slower growth period between November through April, and the higher growth period from May through October. In order to assist in meeting any funding demands, the Company maintains a secured borrowing arrangement with the Federal Home Loan Bank of San Francisco. Included in time deposits at December 31, 2010 were \$2.0 million in CDARS reciprocal time deposits which, under regulatory guidelines, are classified as brokered deposits. There were no brokered deposits at December 31, 2011.

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The Company's time deposits of \$100,000 or more had the following schedule of maturities at December 31, 2011:

(dollars in thousands)	September 30, Amount
Remaining Maturity:	
Three months or less	\$ 7,566
Over three months to six months	5,519
Over six months to 12 months	11,093
Over 12 months	7,446
Total	\$ 31,624

Time deposits of \$100,000 or more are generally from the Company's local business and individual customer base. The potential impact on the Company's liquidity from the withdrawal of these deposits is discussed at the Company's asset and liability management committee meetings, and is considered to be minimal.

Short-term Borrowing Arrangements.

The Company is a member of the FHLB and can borrow up to \$86,388,000 from the FHLB secured by commercial and residential mortgage loans with carrying values totaling \$178,987,000. The Company is required to hold FHLB stock as a condition of membership. At December 31, 2011, the Company held \$2,043,000 of FHLB stock which is recorded as a component of other assets. At this level of stock holdings the Company can borrow up to \$43,466,000. There were no borrowings outstanding as of December 31, 2011. To borrow the \$86,388,000 in available credit the Company would need to purchase \$2,017,000 in additional FHLB stock.

Repurchase Agreements.

Recently Plumas Bank introduced a new product for its larger business customers which use repurchase agreements as an alternative to interest-bearing deposits. The balance in this product at December 31, 2011 was \$8.3 million. Interest paid on this product is similar to that which can be earned on the Bank's premium money market account; however, these are not deposits and are not FDIC insured.

Capital Resources

Shareholders' equity as of December 31, 2011 totaled \$39.6 million up from \$38.0 million as of December 31, 2010.

On January 30, 2009, under the Capital Purchase Program, the Company sold (i) 11,949 shares of the Company's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Shares) and (ii) a ten-year warrant to purchase up to 237,712 shares of the Company's common stock, no par value at an exercise price, subject to anti-dilution adjustments, of \$7.54 per share, for an aggregate purchase price of \$11,949,000 in cash. Ten million of the twelve million in proceeds from the sale of the Series A Preferred Stock was injected into Plumas Bank providing additional capital for the bank to support growth in loans and investment securities and strengthen its capital ratios. The remainder provided funds for holding company activities and general corporate purposes.

It is the policy of the Company to periodically distribute excess retained earnings to the shareholders through the payment of cash dividends. Such dividends help promote shareholder value and capital adequacy by enhancing the marketability of the Company's stock. All authority to provide a return to the shareholders in the form of a cash or stock dividend or split rests with the Board of Directors (the Board). The Board will periodically, but on no regular schedule, review the appropriateness of a cash dividend payment. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. No common cash dividends were paid in 2009, 2010 or 2011 and none are anticipated to be paid in 2012.

The Company is subject to various restrictions on the payment of dividends.

At the request of the FRB, Plumas Bancorp deferred its regularly scheduled quarterly interest payments on its outstanding junior subordinated debentures relating to its two trust preferred securities and suspended quarterly cash dividend payments on its Series A Preferred Stock. Therefore, Plumas Bancorp is currently in arrears with the dividend payments on the Series A Preferred Stock and interest payments on the

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junior subordinated debentures as permitted by the related documentation. As of December 31, 2011 the amount of the arrearage on the dividend payments of the Series A Preferred Stock is \$1,046 thousand representing seven quarterly payments and the amount of the arrearage on the payments on the subordinated debt associated with the trust preferred securities is \$569 thousand also representing seven quarterly payments.

Table of Contents**Capital Standards.**

The Company uses a variety of measures to evaluate its capital adequacy, with risk-based capital ratios calculated separately for the Company and the Bank. Management reviews these capital measurements on a monthly basis and takes appropriate action to ensure that they are within established internal and external guidelines. The FDIC has promulgated risk-based capital guidelines for all state non-member banks such as the Bank. These guidelines establish a risk-adjusted ratio relating capital to different categories of assets and off-balance sheet exposures. There are two categories of capital under the guidelines: Tier 1 capital includes common stockholders' equity, and qualifying trust-preferred securities (including notes payable to unconsolidated special purpose entities that issue trust-preferred securities), less goodwill and certain other deductions, notably the unrealized net gains or losses (after tax adjustments) on available-for-sale investment securities carried at fair market value; Tier 2 capital can include qualifying subordinated debt and the allowance for loan losses, subject to certain limitations. The Series A Preferred Stock qualifies as Tier 1 capital for the Company.

As noted previously, the Company's junior subordinated debentures represent borrowings from its unconsolidated subsidiaries that have issued an aggregate \$10 million in trust-preferred securities. These trust-preferred securities currently qualify for inclusion as Tier 1 capital for regulatory purposes as they do not exceed 25% of total Tier 1 capital, but are classified as long-term debt in accordance with GAAP. On March 1, 2005, the Federal Reserve Board adopted a final rule that allows the continued inclusion of trust-preferred securities (and/or related subordinated debentures) in the Tier I capital of bank holding companies.

The following tables present the capital ratios for the Company and the Bank compared to the standards for bank holding companies and the regulatory minimum requirements for depository institutions as of December 31, 2011 and 2010 (amounts in thousands except percentage amounts).

	September 30, December 31, 2011	September 30, Ratio	September 30, December 31, 2010	September 30, Ratio
	Amount		Amount	
Tier 1 Leverage Ratio				
Plumas Bancorp and Subsidiary	\$ 45,024	9.8%	\$ 42,994	8.9%
Minimum regulatory requirement	18,313	4.0%	19,361	4.0%
Plumas Bank	45,073	9.8%	43,262	8.9%
Minimum requirement for Well-Capitalized institution under the prompt corrective action regulation	22,882	5.0%	24,190	5.0%
Minimum regulatory requirement	18,305	4.0%	19,352	4.0%
Tier 1 Risk-Based Capital Ratio				
Plumas Bancorp and Subsidiary	45,024	13.7%	42,994	12.7%
Minimum regulatory requirement	13,149	4.0%	13,570	4.0%
Plumas Bank	45,073	13.7%	43,262	12.8%
Minimum requirement for Well-Capitalized institution under the prompt corrective action regulation	19,710	6.0%	20,342	6.0%
Minimum regulatory requirement	13,140	4.0%	13,561	4.0%
Total Risk-Based Capital Ratio				
Plumas Bancorp and Subsidiary	49,169	15.0%	47,274	13.9%
Minimum regulatory requirement	26,298	8.0%	27,140	8.0%
Plumas Bank	49,215	15.0%	47,539	14.0%
Minimum requirement for Well-Capitalized institution under the prompt corrective action regulation	32,850	10.0%	33,903	10.0%
Minimum regulatory requirement	26,280	8.0%	27,123	8.0%

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Management believes that the Company and the Bank currently meet their entire capital adequacy requirements including a minimum 9% Tier 1 Leverage Ratio required under the Bank's informal agreement with the FDIC and DFI.

The current and projected capital positions of the Company and the Bank and the impact of capital plans and long-term strategies are reviewed regularly by management. The Company policy is to maintain the Bank's ratios above the prescribed well-capitalized leverage, Tier 1 risk-based and total risk-based capital ratios of 5%, 6% and 10%, respectively, at all times.

Off-Balance Sheet Arrangements

Loan Commitments. In the normal course of business, there are various commitments outstanding to extend credits that are not reflected in the financial statements. Commitments to extend credit and letters of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Annual review of commercial credit lines, letters of credit and ongoing monitoring of outstanding balances reduces the risk of loss associated with these commitments. As of December 31, 2011, the Company had \$79.2 million in unfunded loan commitments and \$50 thousand in letters of credit. This compares to \$71.6 million in unfunded loan commitments and \$164 thousand in letters of credit at December 31, 2010. Of the \$79.2 million in unfunded loan commitments, \$35.1 million and \$44.1 million represented commitments to commercial and consumer customers, respectively. Of the total unfunded commitments at December 31, 2011, \$36.1 million were secured by real estate, of which \$8.8 million was secured by commercial real estate and \$27.3 million was secured by residential real estate in the form of equity lines of credit. The commercial loan commitments not secured by real estate primarily represent business lines of credit, while the consumer loan commitments not secured by real estate primarily represent revolving credit card lines. Since some of the commitments are expected to expire without being drawn upon the total commitment amounts do not necessarily represent future cash requirements.

Operating Leases. The Company leases one depository branch, one lending office and one loan administration office and two non branch automated teller machine locations. Total rental expenses under all operating leases, including premises, totaled \$150,000 and \$20,000, during the years ended December 31, 2011 and 2010, respectively. The expiration dates of the leases vary, with the first such lease expiring during 2012 and the last such lease expiring during 2015.

The reduced level of rental expense during 2010 resulted from the purchase of our Redding branch building on March 31, 2010. Previously we had leased this building. Under the terms of the lease agreement we were provided free rent for a period of time; however, in accordance with applicable accounting standards we recognized monthly rent expense equal to the total payments required under the lease dividend by the term of the lease in months. At the time of the purchase we reversed this accrual recognizing a \$184 thousand reduction in rental expense.

Liquidity

The Company manages its liquidity to provide the ability to generate funds to support asset growth, meet deposit withdrawals (both anticipated and unanticipated), fund customers' borrowing needs, satisfy maturity of short-term borrowings and maintain reserve requirements. The Company's liquidity needs are managed using assets or liabilities, or both. On the asset side, in addition to cash and due from banks, the Company maintains an investment portfolio which includes unpledged U.S. Government-sponsored agency securities that are classified as available-for-sale. On the liability side, liquidity needs are managed by charging competitive offering rates on deposit products and the use of established lines of credit.

The Company is a member of the FHLB and can borrow up to \$86,388,000 from the FHLB secured by commercial and residential mortgage loans with carrying values totaling \$178,987,000. The Company is required to hold FHLB stock as a condition of membership. At December 31, 2011, the Company held \$2,043,000 of FHLB stock which is recorded as a component of other assets. At this level of stock holdings the Company can borrow up to \$43,466,000. There were no borrowings outstanding as of December 31, 2011. To borrow the \$86,388,000 in available credit the Company would need to purchase \$2,017,000 in additional FHLB stock.

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Customer deposits are the Company's primary source of funds. Total deposits were \$391.1 million as of December 31, 2011, a decrease of \$33.8 million, or 8%, from the December 31, 2010 balance of \$424.9 million. Deposits are held in various forms with varying maturities. The Company's securities portfolio, Federal funds sold, Federal Home Loan Bank advances, and cash and due from banks serve as the primary sources of liquidity, providing adequate funding for loans during periods of high loan demand. During periods of decreased lending, funds obtained from the maturing or sale of investments, loan payments, and new deposits are invested in short-term earning assets, such as cash held at the FRB, Federal funds sold and investment securities, to serve as a source of funding for future loan growth. Management believes that the Company's available sources of funds, including borrowings, will provide adequate liquidity for its operations in the foreseeable future.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company we are not required to provide the information required by this item.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following consolidated financial statements of Plumas Bancorp and subsidiary, and report of the independent registered public accounting firm are included in the Annual Report of Plumas Bancorp to its shareholders for the years ended December 31, 2011, 2010 and 2009.

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<u>Reports of Independent Registered Public Accounting Firms</u>	F-1
<u>Consolidated Balance Sheet as of December 31, 2011 and 2010</u>	F-3
<u>Consolidated Statement of Operations for the years ended December 31, 2011, 2010 and 2009</u>	F-4
<u>Consolidated Statement of Changes in Shareholders' Equity for the years ended December 31, 2011, 2010 and 2009</u>	F-6
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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There was no change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Plumas Bancorp and subsidiary (the Company), is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934.

Management, including the undersigned Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting presented in conformity with accounting principles generally accepted in the United States of America as of December 31, 2011. In conducting its assessment, management used the criteria established by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - Integrated Framework. Based on this assessment, management concluded that, as of December 31, 2011, our internal control over financial reporting was effective based on those criteria.

This annual report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this annual report.

/s/ Andrew J. Ryback
Andrew J. Ryback
President and Chief Executive Officer

/s/ Richard L. Belstock
Richard L. Belstock
Senior Vice President and Chief Financial Officer
Dated March 23, 2012

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ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 can be found in Plumas Bancorp's Definitive Proxy Statement pursuant to Regulation 14A under the Securities Exchange Act of 1934, and is by this reference incorporated herein.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 can be found in Plumas Bancorp's Definitive Proxy Statement pursuant to Regulation 14A under the Securities Exchange Act of 1934, and is by this reference incorporated herein.

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

The information required by Item 12 can be found in Plumas Bancorp's Definitive Proxy Statement pursuant to Regulation 14A under the Securities Exchange Act of 1934, and is by this reference incorporated herein.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 can be found in Plumas Bancorp's Definitive Proxy Statement pursuant to Regulation 14A under the Securities Exchange Act of 1934, and is by this reference incorporated herein.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 can be found in Plumas Bancorp's Definitive Proxy Statement pursuant to Regulation 14A under the Securities Exchange Act of 1934, and is by this reference incorporated herein.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Exhibits

The following documents are included or incorporated by reference in this Annual Report on Form 10K.

- 3.1 Articles of Incorporation as amended of Registrant included as exhibit 3.1 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.
- 3.2 Bylaws of Registrant as amended on March 16, 2011 included as exhibit 3.2 to the Registrant's Form 10-K for December 31, 2010, which is incorporated by this reference herein.
- 3.3 Amendment of the Articles of Incorporation of Registrant dated November 1, 2002, is included as exhibit 3.3 to the Registrant's 10-Q for September 30, 2005, which is incorporated by this reference herein.
- 3.4 Amendment of the Articles of Incorporation of Registrant dated August 17, 2005, is included as exhibit 3.4 to the Registrant's 10-Q for September 30, 2005, which is incorporated by this reference herein.
- 4 Specimen form of certificate for Plumas Bancorp included as exhibit 4 to the Registrant's Form S-4, File No. 333-84534, which is incorporated by reference herein.
- 4.1 Certificate of Determination of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, is included as exhibit 4.1 to Registrant's 8-K filed on January 30, 2009, which is incorporated by this reference herein.
- 10.1 Executive Salary Continuation Agreement of Andrew J. Ryback dated December 17, 2008, is included as exhibit 10.1 to the Registrant's 10-K for December 31, 2008, which is incorporated by this reference herein.
- 10.2 Split Dollar Agreement of Andrew J. Ryback dated August 23, 2005, is included as Exhibit 10.2 to the Registrant's 8-K filed on October 17, 2005, which is incorporated by this reference herein.
- 10.8 Director Retirement Agreement of John Flournoy dated March 21, 2007, is included as Exhibit 10.8 to Registrant's 10-Q for March 31, 2007, which is incorporated by this reference herein.
- 10.18 Amended and Restated Director Retirement Agreement of Daniel E. West dated May 10, 2000, is included as Exhibit 10.18 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.

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- 10.19 Consulting Agreement of Daniel E. West dated May 10, 2000, is included as Exhibit 10.19 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.21 Amended and Restated Director Retirement Agreement of Alvin G. Blickenstaff dated April 19, 2000, is included as Exhibit 10.21 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.22 Consulting Agreement of Alvin G. Blickenstaff dated May 8, 2000, is included as Exhibit 10.22 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.24 Amended and Restated Director Retirement Agreement of Gerald W. Fletcher dated May 10, 2000, is included as Exhibit 10.24 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.25 Consulting Agreement of Gerald W. Fletcher dated May 10, 2000, is included as Exhibit 10.25 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.27 Amended and Restated Director Retirement Agreement of Arthur C. Grohs dated May 9, 2000, is included as Exhibit 10.27 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.28 Consulting Agreement of Arthur C. Grohs dated May 9, 2000, is included as Exhibit 10.28 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.33 Amended and Restated Director Retirement Agreement of Terrance J. Reeson dated April 19, 2000, is included as Exhibit 10.33 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.34 Consulting Agreement of Terrance J. Reeson dated May 10, 2000, is included as Exhibit 10.34 to the Registrant's 10-QSB for June 30, 2002, which is incorporated by this reference herein.
- 10.35 Letter Agreement, dated January 30, 2009 by and between Plumas Bancorp, Inc. and the United States Department of the Treasury and Securities Purchase Agreement - Standard Terms attached thereto, is included as exhibit 10.1 to Registrant's 8-K filed on January 30, 2009, which is incorporated by this reference herein.
- 10.36 Form of Senior Executive Officer letter agreement, is included as exhibit 10.2 to Registrant's 8-K filed on January 30, 2009, which is incorporated by this reference herein.
- 10.37 Deferred Fee Agreement of Alvin Blickenstaff is included as Exhibit 10.37 to the Registrant's 10-Q for March 31, 2009, which is incorporated by this reference herein.
- 10.40 2001 Stock Option Plan as amended is included as exhibit 99.1 of the Form S-8 filed July 23, 2002, File No. 333-96957, which is incorporated by this reference herein.
- 10.41 Form of Indemnification Agreement (Plumas Bancorp) is included as Exhibit 10.41 to the Registrant's 10-Q for March 31, 2009, which is incorporated by this reference herein.
- 10.42 Form of Indemnification Agreement (Plumas Bank) is included as Exhibit 10.42 to the Registrant's 10-Q for March 31, 2009, which is incorporated by this reference herein.
- 10.43 Plumas Bank 401(k) Profit Sharing Plan as amended is included as exhibit 99.1 of the Form S-8 filed February 14, 2003, File No. 333-103229, which is incorporated by this reference herein.
- 10.46 1991 Stock Option Plan as amended is included as Exhibit 10.46 to the Registrant's 10-Q for September 30, 2004, which is incorporated by this reference herein.

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10.47	Specimen form of Incentive Stock Option Agreement under the 1991 Stock Option Plan is included as Exhibit 10.47 to the Registrant's 10-Q for September 30, 2004, which is incorporated by this reference herein.
10.48	Specimen form of Non-Qualified Stock Option Agreement under the 1991 Stock Option Plan is included as Exhibit 10.48 to the Registrant's 10-Q for September 30, 2004, which is incorporated by this reference herein.
10.49	Amended and Restated Plumas Bancorp Stock Option Plan is included as Exhibit 10.49 to the Registrant's 10-Q for September 30, 2006, which is incorporated by this reference herein.
10.50	Executive Salary Continuation Agreement of Rose Dembosz, is included as exhibit 10.50 to the Registrant's 10-K for December 31, 2008, which is incorporated by this reference herein.
10.51	First Amendment to Split Dollar Agreement of Andrew J. Ryback, is included as exhibit 10.51 to the Registrant's 10-K for December 31, 2008, which is incorporated by this reference herein.
10.64	First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Alvin Blickenstaff adopted on September 19, 2007, is included as Exhibit 10.64 to the Registrant's 8-K filed on September 25, 2007, which is incorporated by this reference herein.
10.65	First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Arthur C. Grohs adopted on September 19, 2007, is included as Exhibit 10.65 to the Registrant's 8-K filed on September 25, 2007, which is incorporated by this reference herein.
10.66	Director Retirement Agreement of Robert McClintock
10.67	First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Terrance J. Reeson adopted on September 19, 2007, is included as Exhibit 10.67 to the Registrant's 8-K filed on September 25, 2007, which is incorporated by this reference herein.
10.69	First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Daniel E. West adopted on September 19, 2007, is included as Exhibit 10.69 to the Registrant's 8-K filed on September 25, 2007, which is incorporated by this reference herein.
10.70	First Amendment to the Plumas Bank Amended and Restated Director Retirement Agreement for Gerald W. Fletcher adopted on October 9, 2007, is included as Exhibit 10.70 to the Registrant's 10-Q for September 30, 2007, which is incorporated by this reference herein.
10.71	Consent Order issued by the FDIC and CDFI to Plumas Bank on March 18, 2011, is included as Exhibit 10.1 of the Registrant's 8-K filed on March 21, 2011, which is incorporated by this reference herein.
10.72	Stipulation and Consent to the Issuance of Consent Order among Plumas Bank and the FDIC entered into on March 16, 2011, is included as Exhibit 10.2 of the Registrant's 8-K filed on March 21, 2011, which is incorporated by this reference herein.
10.73	Written Agreement with Federal Reserve Bank of San Francisco effective July 28, 2011, is included as Exhibit 10.1 of the Registrant's 8-K filed on July 29, 2011, which is incorporated by this reference herein.
11	Computation of per share earnings appears in the attached 10-K under Item 8 Financial Statements Plumas Bancorp and Subsidiary Notes to Consolidated Financial Statements as Footnote 13 Shareholders' Equity.
21.01	Plumas Bank - California.
21.02	Plumas Statutory Trust I - Connecticut.

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21.03	Plumas Statutory Trust II Connecticut.
23.01	Independent Registered Public Accountant s Consent for audit of year ended December 31, 2011 dated March 23, 2012
23.02	Independent Registered Public Accountant s Consent for audit of years ended December 31, 2010 and December 31, 2009 dated March 23, 2012
31.1	Rule 13a-14(a) [Section 302] Certification of Principal Financial Officer dated March 23, 2012
31.2	Rule 13a-14(a) [Section 302] Certification of Principal Executive Officer dated March 23, 2012
32.1	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated March 23, 2012.
32.2	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated March 23, 2012.
99.1	Certification of Chief Executive Officer pursuant to Section 111(b)(4) of the Emergency Economic Stabilization Act of 2008 dated March 23, 2012.
99.2	Certification of Chief Financial Officer pursuant to Section 111(b)(4) of the Emergency Economic Stabilization Act of 2008 dated March 23, 2012.

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SIGNATURES

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

PLUMAS BANCORP

(Registrant)

Date: March 23, 2012

/s/ ANDREW J. RYBACK
Andrew J. Ryback
President and Chief Executive Officer

/s/ RICHARD L. BELSTOCK
Richard L. Belstock
Senior Vice President and Chief Financial Officer

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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

/s/ DANIEL E. WEST Daniel E. West, <i>Director and Chairman of the Board</i>	Dated: March 23, 2012
/s/ TERRANCE J. REESON Terrance J. Reeson, <i>Director and Vice Chairman of the Board</i>	Dated: March 23, 2012
/s/ ALVIN G. BLICKENSTAFF Alvin G. Blickenstaff, <i>Director</i>	Dated: March 23, 2012
/s/ W. E. ELLIOTT William E. Elliott, <i>Director</i>	Dated: March 23, 2012
/s/ GERALD W. FLETCHER Gerald W. Fletcher, <i>Director</i>	Dated: March 23, 2012
/s/ JOHN FLOURNOY John Flournoy, <i>Director</i>	Dated: March 23, 2012
/s/ ARTHUR C. GROHS Arthur C. Grohs, <i>Director</i>	Dated: March 23, 2012
/s/ ROBERT J. MCCLINTOCK Robert J. McClintock, <i>Director</i>	Dated: March 23, 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders

Plumas Bancorp and Subsidiary

Quincy, California

We have audited the accompanying consolidated balance sheet of Plumas Bancorp and subsidiary (the Company) as of December 31, 2011, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2011, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Horwath LLP

Sacramento, California

March 23, 2012

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders

Plumas Bancorp and Subsidiary

Quincy, California

We have audited the accompanying consolidated balance sheet of Plumas Bancorp and subsidiary (the Company) as of December 31, 2010 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the years in the two year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

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

/s/ Perry-Smith LLP

Sacramento, California

March 23, 2011

Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****CONSOLIDATED BALANCE SHEET****December 31, 2011 and 2010**

	September 30, 2011	September 30, 2010
ASSETS		
Cash and cash equivalents	\$ 63,076,000	\$ 64,628,000
Investment securities	57,917,000	63,017,000
Loans, less allowance for loan losses of \$6,908,000 in 2011 and \$7,324,000 in 2010	287,432,000	307,151,000
Premises and equipment, net	13,457,000	14,431,000
Bank owned life insurance	10,815,000	10,463,000
Other real estate and vehicles acquired through foreclosure	8,680,000	8,884,000
Accrued interest receivable and other assets	13,972,000	15,906,000
Total assets	\$ 455,349,000	\$ 484,480,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Non-interest bearing	\$ 125,931,000	\$ 111,802,000
Interest bearing	265,209,000	313,085,000
Total deposits	391,140,000	424,887,000
Repurchase agreements	8,279,000	
Accrued interest payable and other liabilities	5,986,000	11,295,000
Junior subordinated deferrable interest debentures	10,310,000	10,310,000
Total liabilities	415,715,000	446,492,000
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Serial preferred stock - no par value; 10,000,000 shares authorized; 11,949 issued and outstanding at December 31, 2011 and 2010; aggregate liquidation value of \$13,069,000 at December 31, 2011	11,769,000	11,682,000
Common stock - no par value; 22,500,000 shares authorized; issued and outstanding 4,776,339 shares at December 31, 2011 and 2010	5,998,000	6,027,000
Retained earnings	21,709,000	20,331,000
Accumulated other comprehensive income (loss)	158,000	(52,000)
Total shareholders' equity	39,634,000	37,988,000
Total liabilities and shareholders' equity	\$ 455,349,000	\$ 484,480,000

The accompanying notes are an integral

part of these consolidated financial statements.

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Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENT OF OPERATIONS****For the Years Ended December 31, 2011, 2010 and 2009**

	September 30, 2011	September 30, 2010	September 30, 2009
Interest income:			
Interest and fees on loans	\$ 17,400,000	\$ 18,860,000	\$ 20,658,000
Interest on investment securities:			
Taxable	1,138,000	1,649,000	1,708,000
Exempt from Federal income taxes	6,000	123,000	455,000
Other	124,000	48,000	15,000
Total interest income	18,668,000	20,680,000	22,836,000
Interest expense:			
Interest on deposits	1,469,000	2,696,000	3,169,000
Interest on borrowings		135,000	80,000
Interest on junior subordinated deferrable interest debentures	326,000	312,000	371,000
Other	53,000	4,000	35,000
Total interest expense	1,848,000	3,147,000	3,655,000
Net interest income before provision for loan losses	16,820,000	17,533,000	19,181,000
Provision for loan losses	3,500,000	5,500,000	14,500,000
Net interest income after provision for loan losses	13,320,000	12,033,000	4,681,000
Non-interest income:			
Service charges	3,477,000	3,642,000	3,796,000
Gain on sale of investments	666,000	1,160,000	10,000
Gain on sale of loans	1,939,000	1,055,000	593,000
Earnings on bank owned life insurance policies	352,000	351,000	346,000
Sale of merchant processing portfolio		1,435,000	
Other	728,000	825,000	919,000
Total non-interest income	7,162,000	8,468,000	5,664,000

(Continued)

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PLUMAS BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF OPERATIONS

(Continued)

For the Years Ended December 31, 2011, 2010 and 2009

CONSOLIDATED STATEMENT OF OPERATIONS

	September 30, 2011	September 30, 2010	September 30, 2009
Non-interest expenses:			
Salaries and employee benefits	\$ 9,195,000	\$ 9,732,000	\$ 11,054,000
Occupancy and equipment	3,088,000	3,096,000	3,759,000
Provision for losses on other real estate	579,000	356,000	4,800,000
Other	6,384,000	5,957,000	6,653,000
Total non-interest expenses	19,246,000	19,141,000	26,266,000
Income (loss) before income taxes	1,236,000	1,360,000	(15,921,000)
Provision (benefit) for income taxes	295,000	389,000	(6,775,000)
Net income (loss)	941,000	971,000	(9,146,000)
Preferred stock dividends accrued and discount accretion	(684,000)	(684,000)	(628,000)
Net income (loss) available to common shareholders	\$ 257,000	\$ 287,000	\$ (9,774,000)
Basic earnings (loss) per common share	\$ 0.05	\$ 0.06	\$ (2.05)
Diluted earnings (loss) per common share	\$ 0.05	\$ 0.06	\$ (2.05)
Common dividends per share	\$	\$	\$

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

Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY****For the Years Ended December 31, 2011, 2010 and 2009**

	00000	00000	00000	00000	00000	00000	00000	00000
	Preferred Stock		Common Stock		Retained	Accumulated Other Comprehensive Income (Loss) (Net of Taxes)	Total	Total
	Shares	Amount	Shares	Amount	Earnings	Income (Net of Taxes)	Shareholders Equity	Comprehensive Income (loss)
Balance, January 1, 2009			4,775,339	\$ 5,302,000	\$ 29,818,000	\$ 317,000	\$ 35,437,000	
Comprehensive loss:								
Net loss					(9,146,000)		(9,146,000)	\$ (9,146,000)
Other comprehensive income, net of tax:								
Unrealized gains on securities transferred from held-to-maturity to available-for-sale						197,000	197,000	197,000
Net change in unrealized gains on available-for-sale investment securities						108,000	108,000	108,000
Total comprehensive loss								\$ (8,841,000)
Preferred stock issued	11,949	\$ 11,516,000					11,516,000	
Stock warrants issued				407,000			407,000	
Preferred stock dividends & accretion		79,000			(628,000)		(549,000)	
Stock options exercised and related tax benefit			1,000	5,000			5,000	
Stock-based compensation expense				256,000			256,000	
Balance, December 31, 2009	11,949	11,595,000	4,776,339	5,970,000	20,044,000	622,000	38,231,000	
Comprehensive Income:								
Net Income					971,000		971,000	\$ 971,000
Other comprehensive loss, net of tax:								
Net change in unrealized gains on available-for-sale investment securities						(674,000)	(674,000)	(674,000)
Total comprehensive income								\$ 297,000

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Preferred stock dividends & accretion		87,000			(684,000)		(597,000)
Stock-based compensation expense			57,000				57,000
Balance, December 31, 2010	11,949	\$ 11,682,000	4,776,339	\$ 6,027,000	\$ 20,331,000	\$ (52,000)	\$ 37,988,000

(Continued)

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PLUMAS BANCORP AND SUBSIDIARY

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(Continued)

For the Years Ended December 31, 2011, 2010 and 2009

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	0000	0000	0000	0000	0000	0000	0000	0000
	Preferred Stock		Common Stock		Retained	Accumulated Other Comprehensive Income (Net of Taxes)	Total Shareholders' Equity	Total Comprehensive Income (Loss)
	Shares	Amount	Shares	Amount	Earnings			
Balance, December 31, 2010	11,949	\$ 11,682,000	4,776,339	\$ 6,027,000	\$ 20,331,000	\$ (52,000)	\$ 37,988,000	
Comprehensive Income:								
Net Income					941,000		941,000	\$ 941,000
Other comprehensive income, net of tax:								
Net change in unrealized gains on available-for-sale investment securities						210,000	210,000	210,000
Total comprehensive income								\$ 1,151,000
Reverse accrued dividends on preferred stock					524,000		524,000	
Preferred stock accretion		87,000			(87,000)			
Stock-based compensation expense				(29,000)			(29,000)	
Balance, December 31, 2011	11,949	\$ 11,769,000	4,776,339	\$ 5,998,000	\$ 21,709,000	\$ 158,000	\$ 39,634,000	

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

Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENT OF CASH FLOWS****For the Years Ended December 31, 2011, 2010 and 2009**

	September 30, 2011	September 30, 2010	September 30, 2009
Cash flows from operating activities:			
Net income (loss)	\$ 941,000	\$ 971,000	\$ (9,146,000)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Provision for loan losses	3,500,000	5,500,000	14,500,000
Change in deferred loan origination costs/fees, net	(441,000)	(79,000)	(19,000)
Stock-based compensation expense	(29,000)	57,000	256,000
Depreciation and amortization	1,409,000	1,693,000	1,929,000
Amortization of investment security premiums	410,000	514,000	283,000
Accretion of investment security discounts	(32,000)	(55,000)	(53,000)
Gain on sale of investments	(666,000)	(1,160,000)	(10,000)
Gain on sale of loans held for sale	(1,939,000)	(1,055,000)	(593,000)
Loans originated for sale	(18,550,000)	(21,286,000)	(12,598,000)
Proceeds from loan sales	23,368,000	14,873,000	11,393,000
Provision for losses on other real estate	579,000	356,000	4,800,000
Proceeds from secured borrowing		4,284,000	
Net (gain) loss on sale of premises and equipment	(3,000)	4,000	(6,000)
Net loss (gain) on sale of other real estate and vehicles owned	611,000	(58,000)	198,000
Earnings on bank owned life insurance policies	(352,000)	(351,000)	(346,000)
Provision (benefit) for deferred income taxes	259,000	385,000	(3,852,000)
Decrease (increase) in accrued interest receivable and other assets	1,575,000	5,325,000	(7,021,000)
(Decrease) increase in accrued interest payable and other liabilities	(554,000)	197,000	355,000
Net cash provided by operating activities	10,086,000	10,115,000	70,000

(Continued)

Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****CONSOLIDATED STATEMENT OF CASH FLOWS**

(Continued)

For the Years Ended December 31, 2011, 2010 and 2009**CONSOLIDATED STATEMENT OF CASH FLOWS**

	September 30, 2011	September 30, 2010	September 30, 2009
Cash flows from investing activities:			
Proceeds from matured and called available-for-sale investment securities	\$ 29,182,000	\$ 31,895,000	\$ 8,000,000
Proceeds from matured and called held-to-maturity investment securities			1,836,000
Proceeds from sale of held-to-maturity securities			943,000
Proceeds from sale of available-for-sale securities	29,404,000	40,902,000	86,000
Purchases of available-for-sale investment securities	(59,247,000)	(57,238,000)	(65,876,000)
Purchases of held-to-maturity investment securities			(1,586,000)
Proceeds from principal repayments from available-for-sale government-guaranteed mortgage-backed securities	6,406,000	8,927,000	7,320,000
Net decrease in loans	3,386,000	16,623,000	8,683,000
Proceeds from sale of vehicles	33,000	177,000	270,000
Proceeds from sale of other real estate	4,937,000	3,462,000	1,992,000
Purchases of premises and equipment	(271,000)	(1,210,000)	(253,000)
Net cash provided by (used in) investing activities	13,830,000	43,538,000	(38,585,000)
Cash flows from financing activities:			
Net increase (decrease) in demand, interest-bearing and savings deposits	3,534,000	(3,353,000)	37,383,000
Net (decrease) increase in time deposits	(37,281,000)	(5,015,000)	24,379,000
Net increase in securities sold under agreements to repurchase	8,279,000		
Net decrease in short-term borrowings		(20,000,000)	(14,000,000)
Proceeds from long-term debt			20,000,000
Repayment of long-term debt		(20,000,000)	
Issuance of preferred stock, net of discount			11,516,000
Payment of cash dividend on preferred stock		(150,000)	(473,000)
Issuance of common stock warrant			407,000
Proceeds from exercise of stock options			5,000
Net cash (used in) provided by financing activities	(25,468,000)	(48,518,000)	79,217,000
(Decrease) increase in cash and cash equivalents	(1,552,000)	5,135,000	40,702,000
Cash and cash equivalents at beginning of year	64,628,000	59,493,000	18,791,000
Cash and cash equivalents at end of year	\$ 63,076,000	\$ 64,628,000	\$ 59,493,000

(Continued)

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PLUMAS BANCORP AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CASH FLOWS

(Continued)

For the Years Ended December 31, 2011, 2010 and 2009

CONSOLIDATED STATEMENT OF CASH FLOWS

	September 30, 2011	September 30, 2010	September 30, 2009
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	\$ 1,688,000	\$ 3,000,000	\$ 3,666,000
Income taxes	\$ 2,000	\$	\$ 65,000
Non-cash investing activities:			
Real estate acquired through foreclosure	\$ 5,710,000	\$ 1,391,000	\$ 14,053,000
Vehicles acquired through repossession	\$ 79,000	\$ 112,000	\$ 245,000
Investment securities transferred from held-to-maturity to available-for-sale	\$	\$	\$ 11,722,000

The accompanying notes are an integral

part of these consolidated financial statements.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE BUSINESS OF PLUMAS BANCORP

During 2002, Plumas Bancorp (the Company) was incorporated as a bank holding company for the purpose of acquiring Plumas Bank (the Bank) in a one bank holding company reorganization. This corporate structure gives the Company and the Bank greater flexibility in terms of operation expansion and diversification. The Company formed Plumas Statutory Trust I (Trust I) for the sole purpose of issuing trust preferred securities on September 26, 2002. The Company formed Plumas Statutory Trust II (Trust II) for the sole purpose of issuing trust preferred securities on September 28, 2005.

The Bank operates eleven branches in California, including branches in Alturas, Chester, Fall River Mills, Greenville, Kings Beach, Portola, Quincy, Redding, Susanville, Tahoe City, and Truckee. The Bank's administrative headquarters is in Quincy, California. In addition, the Bank operates a loan administrative office in Reno, Nevada and a lending office specializing in government-guaranteed lending in Auburn, California. The Bank's primary source of revenue is generated from providing loans to customers who are predominately small and middle market businesses and individuals residing in the surrounding areas.

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which, in part, permanently raised the current standard maximum deposit insurance amount to \$250,000. Amendments related to the enactment of the Dodd-Frank Act provide full deposit insurance coverage for noninterest bearing deposit transaction accounts beginning December 31, 2010 for a two year period.

2. REGULATORY MATTERS

On February 15, 2012, the Bank received notice from the Federal Deposit Insurance Corporation (FDIC) and the California Department of Financial Institutions (DFI) that the Consent Order with the FDIC and the DFI which was effective on March 16, 2011 had been terminated. While the Bank is no longer subject to an Order, the Bank has entered into an informal agreement with the FDIC and DFI which, among other things, requests that the Bank continue to maintain a Tier 1 Leverage Capital Ratio of 9% which is in excess of that required for well capitalized institutions and continue to reduce its level of classified asset balances that were outstanding as of September 30, 2011 to not more than 50% of Tier 1 Capital plus the allowance for loan losses. At December 31, 2011 this ratio was 68%.

On July 28, 2011 the Company entered into an agreement with the Federal Reserve Bank of San Francisco (the FRB Agreement). Under the terms of the FRB Agreement, Plumas Bancorp has agreed to take certain actions that are designed to maintain its financial soundness so that it may continue to serve as a source of strength to the Bank. Among other things, the FRB Agreement requires prior written approval related to the payment or taking of dividends and distributions, making any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities, incurrence of debt, and the purchase or redemption of stock. In addition, the FRB Agreement requires Plumas Bancorp to submit, within 60 days of the FRB Agreement, a written statement of Plumas Bancorp's planned sources and uses of cash for debt service, operating expense and other purposes (Cash Flow Statement) for the remainder of 2011 and annually thereafter. The Company submitted the Cash Flow Statements within the required time frames.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and the consolidated accounts of its wholly-owned subsidiary, Plumas Bank. All significant intercompany balances and transactions have been eliminated.

Plumas Statutory Trust I and Trust II are not consolidated into the Company's consolidated financial statements and, accordingly, are accounted for under the equity method. The Company's investment in Trust I of \$283,000 and Trust II of \$154,000 are included in accrued interest receivable and other assets on the consolidated balance sheet. The junior subordinated deferrable interest debentures issued and guaranteed by the Company and held by Trust I and Trust II are reflected as debt on the consolidated balance sheet.

The accounting and reporting policies of Plumas Bancorp and subsidiary conform with accounting principles generally accepted in the United States of America and prevailing practices within the banking industry.

Reclassifications

Certain reclassifications have been made to prior years' balances to conform to the classifications used in 2011.

Segment Information

Management has determined that since all of the banking products and services offered by the Company are available in each branch of the Bank, all branches are located within the same economic environment and management does not allocate resources based on the performance of different lending or transaction activities, it is appropriate to aggregate the Bank branches and report them as a single operating segment. No customer accounts for more than 10 percent of revenues for the Company or the Bank.

Use of Estimates

To prepare financial statements in conformity with accounting principles generally accepted in the United States of America management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and actual results could differ. The allowance for loan losses, loan servicing rights, deferred tax assets, and fair values of financial instruments are particularly subject to change.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and due from banks and Federal funds sold are considered to be cash equivalents. Generally, Federal funds are sold for one day periods. As of December 31, 2011 all cash held with other federally insured institutions was fully insured by the FDIC. Net cash flows are reported for customer loans and deposit transactions and repurchase agreements.

Investment Securities

Investments are classified into one of the following categories:

Available-for-sale securities reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

Held-to-maturity securities, which management has the positive intent and ability to hold, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances.

During 2009, management determined they no longer had the positive intent to hold their held-to-maturity securities and transferred their held-to-maturity securities to available-

for-sale (see note 5). This transfer increased the Company's flexibility in managing its investment portfolio allowing the investments to be sold in implementing its asset/liability management strategies and in response to changes in interest rates, prepayment rates and similar factors. All transfers between categories are accounted for at fair value. There were no transfers between categories during 2011 or 2010.

As of December 31, 2011 and 2010 the Company did not have any investment securities classified as trading and gains or losses on the sale of securities are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums accounted for by the level yield method with no pre-payment anticipated.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether such a decline in their fair value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term "other than temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other than temporary, and management does not intend to sell the security or it is more likely than not that the Company will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovering its forecasted cost,

the entire impairment loss is recognized as a charge to earnings.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in Federal Home Loan Bank Stock

As a member of the Federal Home Loan Bank (FHLB) System, the Bank is required to maintain an investment in the capital stock of the FHLB. The investment is carried at cost classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. At December 31, 2011 and 2010, FHLB stock totaled \$2,043,000 and \$2,188,000, respectively. On the consolidated balance sheet, FHLB stock is included in accrued interest receivable and other assets.

Loans Held for Sale, Loan Sales and Servicing

Included in the loan portfolio are loans which are 75% to 85% guaranteed by the Small Business Administration (SBA), US Department of Agriculture Rural Business Cooperative Service (RBS) and Farm Services Agency (FSA). The guaranteed portion of these loans may be sold to a third party, with the Bank retaining the unguaranteed portion. The Company can receive a premium in excess of the adjusted carrying value of the loan at the time of sale.

At December 31, 2010, we recorded the proceeds from the sale of the guaranteed portions of SBA loans that were subject to a premium refund obligation, which totaled \$4,284,000, were recorded as a secured borrowing and such secured borrowings were included in other liabilities on the balance sheet. Once the premium refund obligation elapsed the transaction was recorded as a sale with the guaranteed portions of loans and the secured borrowing removed from the balance sheet and the resulting gain on sale recorded. Included in commercial loans at December 31, 2010 is \$4,284,000 in guaranteed portions of SBA loans sold subject to a 90-day premium refund obligation. In February 2011, the SBA eliminated the refund obligation period and the Company is no longer required to defer gain recognition.

As of December 31, 2011 and 2010 the Company had \$3,091,000 and \$5,208,000, respectively in government guaranteed loans held for sale. Loans held for sale are recorded at the lower of cost or fair value and therefore may be reported at fair value on a non-recurring basis. The fair values for loans held for sale are based on either observable transactions of similar instruments or formally committed loan sale prices.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans Held for Sale, Loan Sales and Servicing (continued)

Government guaranteed loans with unpaid balances of \$47,708,000 and \$33,686,000 were being serviced for others at December 31, 2011 and 2010, respectively. The Company also services loans previously sold to the Federal National Mortgage Association (FNMA) totaling \$1,932,000 and \$2,185,000 as of December 31, 2011 and 2010, respectively.

The Company accounts for the transfer and servicing of financial assets based on the fair value of financial and servicing assets it controls and liabilities it has assumed, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are recorded at fair value and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. Servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with non-interest income on the statement of operations. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

The Company's investment in the loan is allocated between the retained portion of the loan, the servicing asset, the interest-only (IO) strip, and the sold portion of the loan based on their fair values on the date the loan is sold. The gain on the sold portion of the loan is recognized as income at the time of sale.

The carrying value of the retained portion of the loan is discounted based on the estimated value of a comparable non-guaranteed loan. The servicing asset is recognized and amortized over the estimated life of the related loan. Assets (accounted for as IO strips) are recorded at the fair value of the difference between note rates and rates paid to purchasers (the interest spread) and contractual servicing fees, if applicable. IO strips are carried at fair value with gains or losses recorded as a component of shareholders' equity, similar to available-for-sale investment securities. Significant future prepayments of these loans will result in the recognition of additional amortization of related servicing assets and an adjustment to the carrying value of related IO strips.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans

Loans that management has the intent and ability to hold for foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of purchase premiums or discounts, deferred loan fees and costs, and an allowance for loan losses. Loans, if any, that are transferred from loans held for sale are carried at the lower of principal balance or market value at the date of transfer, adjusted for accretion of discounts. Interest is accrued daily based upon outstanding loan balances. However, when, in the opinion of management, loans are considered to be impaired and the future collectibility of interest and principal is in serious doubt, loans are placed on nonaccrual status and the accrual of interest income is suspended. Any interest accrued but unpaid is charged against income. Payments received are applied to reduce principal to the extent necessary to ensure collection. A loan is moved to non-accrual status in accordance with the Company's policy, typically after 90 days of non-payment unless well secured and in the process of collection. Subsequent payments on these loans, or payments received on nonaccrual loans for which the ultimate collectibility of principal is not in doubt, are applied first to earned but unpaid interest and then to principal.

Loan origination fees, commitment fees, direct loan origination costs and purchased premiums and discounts on loans are deferred and recognized as an adjustment of yield, to be amortized to interest income over the contractual term of the loan. The unamortized balance of deferred fees and costs is reported as a component of net loans.

The Company may acquire loans through a business combination or a purchase for which differences may exist between the contractual cash flows and the cash flows expected to be collected due, at least in part, to credit quality. When the Company acquires such loans, the yield that may be accreted (accretable yield) is limited to the excess of the Company's estimate of undiscounted cash flows expected to be collected over the Company's initial investment in the loan. The excess of contractual cash flows over cash flows expected to be collected may not be recognized as an adjustment to yield, loss, or a valuation allowance. Subsequent increases in cash flows expected to be collected generally should be recognized prospectively through adjustment of the loan's yield over its remaining life. Decreases in cash flows expected to be collected should be recognized as an impairment.

The Company may not carry over or create a valuation allowance in the initial accounting for loans acquired under these circumstances. At December 31, 2011 and 2010, there were no such loans being accounted for under this policy.

Allowance for Loan Losses

The allowance for loan losses is an estimate of credit losses inherent in the Company's loan portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired loans and general reserves for inherent losses related to loans that are not impaired but collectively evaluated for impairment.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (continued)

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, it may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral.

A restructuring of a debt constitutes a troubled debt restructuring (TDR) if the Company, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

The determination of the general reserve for loans that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses over the past eight quarters by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the loan portfolio, and probable losses inherent in the portfolio taken as a whole. Effective for the third quarter of 2010, the Company modified its method of estimating the allowance for loan losses for loans collectively evaluated for impairment. This modification incorporated historical loss experience based on a rolling eight quarters ending with the most recently completed calendar quarter to identified pools of loans. This modification did not have a material affect on the Company's allowance for loans losses or provision for loan losses. No modifications to the allowance for loan losses methodology were made in 2011.

The Company maintains a separate allowance for each portfolio segment (loan type). These portfolio segments include commercial and industrial, agricultural, real estate construction (including land and development loans), commercial real estate mortgage, residential mortgage, home equity loans, installment loans, automobile loans and other loans primarily consisting of credit card receivables. The allowance for loan losses attributable to each portfolio segment, which includes both impaired loans and loans that are not impaired, is combined to determine the Company's overall allowance, and is included as a component of loans on the consolidated balance sheet.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (continued)

The Company assigns a risk rating to all loans and periodically, but not less than annually, performs detailed reviews of all such loans over \$100,000 to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During these internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual loan.

The risk ratings can be grouped into five major categories, defined as follows:

Pass A pass loan is a strong credit with no existing or known potential weaknesses deserving of management's close attention.

Watch A Watch loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the Company's credit position at some future date. Watch loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard A substandard loan is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include a project's lack of marketability, inadequate cash flow or

collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful Loans classified doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

Loss Loans classified as loss are considered uncollectible and charged off immediately.

The general reserve component of the allowance for loan losses associated with loans collectively evaluated for impairment also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) historical losses and (2) other qualitative factors, including inherent credit risk. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (continued)

Commercial Commercial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Agricultural Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of Company and borrowers: commodity prices and weather conditions.

Real estate Residential and Home Equity Lines of Credit The degree of risk in residential real estate lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Real estate Commercial Commercial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

Real estate Construction and Land Development Construction and land development loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Installment An installment loan portfolio is usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Other Other loans primarily consist of automobile and credit card loans and are similar in nature to installment loans.

Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Allowance for Loan Losses** (continued)

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors and management review the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the FDIC and DFI, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

The Company also maintains a separate allowance for off-balance-sheet commitments. Management estimates anticipated losses using historical data and utilization assumptions. The allowance for these commitments totaled \$141,000 at December 31, 2011 and 2010, respectively and is included in accrued interest payable and other liabilities in the consolidated balance sheet.

Other Real Estate

Other real estate owned relates to real estate acquired in full or partial settlement of loan obligations, which was \$8,623,000 (\$11,668,000 less a valuation allowance of \$3,045,000) at December 31, 2011 and \$8,867,000 (\$13,056,000 less a valuation allowance of \$4,188,000) at December 31, 2010. Proceeds from sales of other real estate owned totaled \$4,937,000, \$3,462,000 and \$1,992,000 for the years ended December 31, 2011, 2010 and 2009, respectively. For the year ended December 31, 2011 the Company recorded a loss on sale of other real estate owned of \$606,000. This compares to a gain on sale of \$43,000 during 2010 and a loss on sale of \$158,000 during 2009. Other real estate owned is initially recorded at fair value less cost to sell when acquired, any excess of the Bank's recorded investment in the loan balance and accrued interest income over the estimated fair value of the property less costs to sell is charged against the allowance for loan losses. A valuation allowance for losses on other real estate is maintained to provide for temporary declines in value. The allowance is established through a provision for losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or write-downs resulting from permanent impairment are recorded in other income or expenses as incurred.

The following table provides a summary of the change in the OREO balance for the years ended December 31, 2011 and 2010:

	September 30, Year Ended December 31, 2011	September 30, Year Ended December 31, 2010
Beginning balance	\$ 8,867,000	\$ 11,204,000
Additions	5,825,000	1,438,000
Dispositions	(5,490,000)	(3,419,000)
Write-downs	(579,000)	(356,000)
Ending balance	\$ 8,623,000	\$ 8,867,000

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PLUMAS BANCORP AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Intangible Assets

Intangible assets consist of core deposit intangibles related to branch acquisitions and are amortized using the straight-line method over ten years. The Company evaluates the recoverability and remaining useful life annually to determine whether events or circumstances warrant a revision to the intangible asset or the remaining period of amortization. There were no such events or circumstances in 2011 or 2010.

Premises and Equipment

Premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful lives of premises are estimated to be twenty to thirty years. The useful lives of furniture, fixtures and equipment are estimated to be two to ten years. Leasehold improvements are amortized over the life of the asset or the life of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. The Company evaluates premises and equipment for financial impairment as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

Bank Owned Life Insurance

The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Income Taxes

The Company files its income taxes on a consolidated basis with its subsidiary. Income tax expense is the total of current year income tax due or refundable and the change in deferred tax assets and liabilities.

Deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amount of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. A valuation allowance is recognized if, based on the weight of available evidence management believes it is more likely than not that some portion or all of the deferred tax assets will not be realized. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Accounting for Uncertainty in Income Taxes

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial

statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated statement of operations. There have been no significant changes to unrecognized tax benefits or accrued interest and penalties for the years ended December 31, 2011 and 2010.

Earnings (Loss) Per Share

Basic earnings (loss) per share (EPS), which excludes dilution, is computed by dividing income (loss) available to common stockholders (net income or (loss) less preferred dividends) by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options, result in the issuance of common stock which shares in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options in computing diluted EPS.

Comprehensive Income:

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale which are also recognized as separate components of equity.

Dividend Restrictions

Banking regulations require maintaining certain capital levels and may limit the dividend paid by the bank to the holding company or by the holding company to shareholders. In addition, the Bank and the Bancorp cannot currently pay dividends without the prior approval of their primary regulators.

Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Stock-Based Compensation**

Compensation expense related to the Company's Stock Option Plan, net of related tax (expense)/benefit, recorded in 2011, 2010 and 2009 totaled \$(38,000), \$53,000 and \$237,000 or \$(0.01), \$0.01 and \$0.05 per diluted share, respectively. Compensation expense is recognized over the vesting period on a straight line accounting basis.

The Company determines the fair value of options on the date of grant using a Black-Scholes-Merton option pricing model that uses assumptions based on expected option life, expected stock volatility and the risk-free interest rate. The expected volatility assumptions used by the Company are based on the historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected life of the Company's stock options. The Company bases its expected life assumption on its historical experience and on the terms and conditions of the stock options it grants to employees. The risk-free rate is based on the U.S. Treasury yield curve for the periods within the contractual life of the options in effect at the time of the grant. The Company also makes assumptions regarding estimated forfeitures that will impact the total compensation expenses recognized under the Plans.

The fair value of each option is estimated on the date of grant using the following assumptions.

	September 30, 2011
Expected life of stock options	5.3 years
Risk free interest rate	2.26%
Volatility	46.1%
Dividend yields	3.05%
Weighted-average fair value of options granted during the year	\$ 0.99

No options were granted during the years ended December 31, 2010 and 2009.

Adoption of New Accounting Standards

In April 2011, the FASB amended existing guidance for assisting a creditor in determining whether a restructuring is a troubled debt restructuring. The amendments clarify the guidance for a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties. With regard to determining whether a concession has been granted, the ASU clarifies that creditors are precluded from using the effective interest method to determine whether a concession has been granted. In the absence of using the effective interest method, a creditor must now focus on other considerations such as the value of the underlying collateral, evaluation of other collateral or guarantees, the debtor's ability to access other funds at market rates, interest rate increases and whether the restructuring results in a delay in payment that is insignificant. This guidance is effective for interim and annual reporting periods ending after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. For purposes of measuring impairment on newly identified troubled debt restructurings, the amendments should be applied prospectively for the first interim or annual period beginning on or after June 15, 2011. The effect of adopting this standard did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Adoption of New Accounting Standards (continued)

In May, 2011, the FASB issued an amendment to achieve common fair value measurement and disclosure requirements between U.S. and International accounting principles. Overall, the guidance is consistent with existing U.S. accounting principles; however, there are some amendments that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this guidance are effective for interim and annual reporting periods beginning after December 15, 2011. The Company is currently evaluating the impact of this amendment on the consolidated financial statements.

In June 2011, the FASB amended existing guidance and eliminated the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. The amendment requires that comprehensive income be presented in either a single continuous statement or in two separate consecutive statements. The amendments in this guidance are effective as of the beginning of a fiscal reporting year, and interim periods within that year, that begins after December 15, 2011. Early adoption is permitted. The adoption of this amendment will change the presentation of the components of comprehensive income for the Company, as this presentation will no longer be included as part of the consolidated statement of shareholders' equity.

Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

4. FAIR VALUE MEASUREMENTS**Fair Value of Financial Instruments**

The estimated fair values of the Company's financial instruments are as follows:

	September 30, December 31, 2011 Carrying Amount	September 30, December 31, 2011 Fair Value	September 30, December 31, 2010 Carrying Amount	September 30, December 31, 2010 Fair Value
Financial assets:				
Cash and cash equivalents	\$ 63,076,000	\$ 63,076,000	\$ 64,628,000	\$ 64,628,000
Investment securities	57,917,000	57,917,000	63,017,000	63,017,000
Loans, net	287,432,000	290,710,000	307,151,000	304,045,000
FHLB stock	2,043,000	N/A	2,188,000	N/A
Accrued interest receivable	1,638,000	1,638,000	1,784,000	1,784,000
Financial liabilities:				
Deposits	\$ 391,140,000	\$ 391,410,000	\$ 424,887,000	\$ 425,009,000
Repurchase agreements	8,279,000	8,279,000		
Junior subordinated deferrable interest debentures	10,310,000	3,079,000	10,310,000	2,992,000
Accrued interest payable	783,000	783,000	623,000	623,000

These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following methods and assumptions were used by management to estimate the fair value of its financial instruments at December 31, 2011 and December 31, 2010:

Cash and cash equivalents: For cash and cash equivalents, the carrying amount is estimated to be fair value.

Investment securities: For investment securities, fair values are based on quoted market prices, where available. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers.

Loans: For variable-rate loans that reprice frequently with no significant change in credit risk, fair values are based on carrying values. Fair values of loans held for sale, if any, are estimated using quoted market prices for similar loans. The fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered at each reporting date for loans with similar terms to borrowers of comparable creditworthiness. The fair value of loans is adjusted for the allowance for loan losses. The carrying value of accrued interest receivable approximates its fair value.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

The fair value of impaired loans is based on either the estimated fair value of underlying collateral or estimated cash flows, discounted at the loan's effective rate. Assumptions regarding credit risk and cash flows are determined using available market information and specific borrower information.

FHLB stock: It was not practicable to determine the fair value of the FHLB stock due to restrictions placed on its transferability.

Deposits: The fair values for demand deposits are, by definition, equal to the amount payable on demand at the reporting date represented by their carrying amount. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow analysis using interest rates offered at each reporting date by the Bank for certificates with similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

Repurchase agreements:

The carrying amount of securities sold under repurchase agreements is estimated based on bid quotations received from brokers.

Junior subordinated deferrable interest debentures: The fair value of junior subordinated deferrable interest debentures was determined based on the current market value for like kind instruments of a similar maturity and structure.

Commitments to extend credit and letters of credit: The fair value of commitments are estimated using the fees currently charged to enter into similar agreements. Commitments to extend credit are primarily for variable rate loans and letters of credit.

For these commitments, there is no significant difference between the committed amounts and their fair values and therefore, these items are not included in the table above.

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

The Company measures fair value under the fair value hierarchy described below.

Level 1: Quoted prices for identical instruments traded in active exchange markets.

Level 2: Quoted prices (unadjusted) for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.

Level 3: Model based techniques that use one significant assumption not observable in the market. These unobservable assumptions reflect the Company's estimates of assumptions that market participants would use on pricing the asset or liability. Valuation techniques include management judgment and estimation which may be significant.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Management monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management evaluates the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total assets, total liabilities or total earnings.

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PLUMAS BANCORP AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and non recurring basis as of December 31, 2011 and December 31, 2010, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value:

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	September 30, Total Fair Value	September 30, Fair Value Measurements at December 31, 2011 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	September 30, Fair Value Measurements at December 31, 2011 Using Significant Other Observable Inputs (Level 2)	September 30, Fair Value Measurements at December 31, 2011 Using Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government-sponsored agencies	\$ 32,777,000		\$ 32,777,000	
U.S. Government-sponsored agencies collateralized by mortgage obligations	25,140,000		25,140,000	
	\$ 57,917,000	\$	\$ 57,917,000	\$

	September 30, Total Fair Value	September 30, Fair Value Measurements at December 31, 2010 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	September 30, Fair Value Measurements at December 31, 2010 Using Significant Other Observable Inputs (Level 2)	September 30, Fair Value Measurements at December 31, 2010 Using Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Treasury securities	\$ 1,032,000		\$ 1,032,000	
U.S. Government-sponsored agencies	40,430,000		40,430,000	
U.S. Government-sponsored agencies collateralized by mortgage obligations	21,273,000		21,273,000	
Obligations of states and political subdivisions	282,000		282,000	

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\$ 63,017,000 \$ \$ 63,017,000 \$

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(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

The fair value of securities available-for-sale equals quoted market price, if available. If quoted market prices are not available, fair value is determined using quoted market prices for similar securities. There were no changes in the valuation techniques used during 2011 or 2010. There were no transfers between levels during the year ended December 31, 2011 or December 31, 2010. Changes in fair market value are recorded in other comprehensive income.

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2011 are summarized below:

	September 30, Total Fair Value	September 30, Quoted Prices in Active Markets for Identical Assets (Level 1)	September 30, Significant Other Observable Inputs (Level 2)	September 30, Fair Value Measurements at December 31, 2011 Using Significant Unobservable Inputs (Level 3)	September 30, Total Gains (Losses)
Assets:					
Impaired loans:					
Commercial	\$ 2,942,000			\$ 2,942,000	\$ (315,000)
Agricultural	245,000			245,000	(250,000)
Real estate residential	2,558,000			2,558,000	(297,000)
Real estate commercial	3,701,000			3,701,000	(52,000)
Real estate construction and land development	4,070,000			4,070,000	(402,000)
Equity lines of credit	49,000			49,000	(100,000)
Installment					(1,000)
Other					
Total impaired loans	13,565,000			13,565,000	(1,417,000)
Other real estate:					
Real estate residential	644,000			644,000	(85,000)
Real estate commercial	5,021,000			5,021,000	(54,000)
Real estate construction and land development	2,958,000			2,958,000	(440,000)
Total other real estate	8,623,000			8,623,000	(579,000)
	\$22,188,000	\$	\$	\$ 22,188,000	\$ (1,996,000)

Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

Assets and liabilities measured at fair value on a non-recurring basis at December 31, 2010 are summarized below:

	September 30, Total Fair Value	September 30, Quoted Prices in Active Markets for Identical Assets (Level 1)	September 30, Significant Other Observable Inputs (Level 2)	September 30, Significant Unobservable Inputs (Level 3)	September 30, Fair Value Measurements at December 31, 2010 Using Total Gains (Losses)
Assets:					
Impaired loans:					
Commercial	\$ 914,000			\$ 914,000	\$ (259,000)
Agricultural	243,000			243,000	(117,000)
Real estate residential	1,505,000			1,505,000	(213,000)
Real estate commercial	2,009,000			2,009,000	(201,000)
Real estate construction and land development	8,850,000			8,850,000	(559,000)
Equity lines of credit					(10,000)
Installment					(8,000)
Other					11,000
Total impaired loans	13,521,000			13,521,000	(1,356,000)
Other real estate:					
Real estate residential	525,000			525,000	(14,000)
Real estate commercial	2,348,000			2,348,000	(141,000)
Real estate construction and land development	5,994,000			5,994,000	(80,000)
Total other real estate	8,867,000			8,867,000	(235,000)
	\$ 22,388,000	\$	\$	\$ 22,388,000	\$ (1,591,000)

The Company has no liabilities which are reported at fair value.

The following methods were used to estimate the fair value of each class of assets above.

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses or loans that have been subject to partial charge-offs are generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Total losses of \$1,417,000 and \$1,356,000 represent

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impairment charges recognized during the years ended December 31, 2011 and December 31, 2010, respectively related to the above impaired loans.

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Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

4. FAIR VALUE MEASUREMENTS (Continued)

Other Real Estate: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

5. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2011 and 2010 consisted of the following:

	September 30,	September 30,	September 30,	September 30,
		2011		
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	Losses	Value
Available-for-Sale				
Debt securities:				
U.S. Government-sponsored agencies	\$ 32,708,000	\$ 92,000	\$ (23,000)	\$ 32,777,000
U.S. Government-sponsored agencies collateralized by mortgage obligations	24,941,000	251,000	(52,000)	25,140,000
	\$ 57,649,000	\$ 343,000	\$ (75,000)	\$ 57,917,000

Net unrealized gains on available-for-sale investment securities totaling \$268,000 were recorded, net of \$110,000 in tax expense, as accumulated other comprehensive income within shareholders' equity at December 31, 2011. During the year ended December 31, 2011 the Company sold twenty-seven available-for-sale securities for \$29,404,000, recording a \$666,000 gain on sale. No securities were sold at a loss.

	September 30,	September 30,	September 30,	September 30,
		2010		
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	Losses	Value
Debt securities:				
U.S. Treasury securities	\$ 1,025,000	\$ 7,000		\$ 1,032,000
U.S. Government-sponsored agencies	40,662,000	58,000	\$ (290,000)	40,430,000
U.S. Government-sponsored agencies collateralized by mortgage obligations	21,110,000	270,000	(107,000)	21,273,000
Obligations of states and political subdivisions	308,000		(26,000)	282,000
	\$ 63,105,000	\$ 335,000	\$ (423,000)	\$ 63,017,000

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Net unrealized losses on available-for-sale investment securities totaling \$88,000 were recorded, net of \$36,000 in tax benefit, as accumulated other comprehensive loss within shareholders' equity at December 31, 2010. During the year ended December 31, 2010 the Company sold sixty-five available-for-sale securities for \$40,902,000, recording a \$1,160,000 gain on sale. During 2009 we sold one available-for-sale investment security for \$86,000, recording a \$1,000 gain on sale.

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Table of Contents**PLUMAS BANCORP AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

5. INVESTMENT SECURITIES (Continued)**Held-to-Maturity**

There were no securities classified as held-to-maturity at December 31, 2011 or December 31, 2010. Related to a significant deterioration in creditworthiness, during 2009 we sold five held-to maturity securities for \$943,000, recording a \$9,000 gain on sale. At December 31, 2009 the Company transferred all of its obligations of states and political subdivisions from held-to-maturity to available-for-sale as it was determined that management no longer had the intent to hold these investments to maturity. At the time of the transfer these securities had an amortized cost of \$11,387,000 and a fair value of \$11,722,000. There were no sales or transfers of held-to-maturity investment securities during the years ended December 31, 2011 or 2010.

Investment securities with unrealized losses at December 31, 2011 and 2010 are summarized and classified according to the duration of the loss period as follows:

	September 30, Less than 12 Months Fair Value	September 30, Unrealized Losses
December 31, 2011		
Debt securities:		
U.S. Government-sponsored agencies	\$ 11,044,000	\$ 23,000
U.S. Government- sponsored agencies collateralized by mortgage obligations	9,144,000	52,000
	\$ 20,188,000	\$ 75,000
	September 30, Less than 12 Months Fair Value	September 30, Unrealized Losses
December 31, 2010		
Debt securities:		
U.S. Government-sponsored agencies	\$ 14,763,000	\$ 290,000
U.S. Government-sponsored agencies collateralized by mortgage obligations	13,205,000	107,000
Obligations of states and political subdivisions	282,000	26,000
	\$ 28,250,000	\$ 423,000

There were no securities in a loss position for more than one year as of December 31, 2011 and 2010.

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(Continued)

5. INVESTMENT SECURITIES (Continued)

At December 31, 2011, the Company held 47 securities of which 12 were in a loss position. Of the securities in a loss position, all were in a loss position for less than twelve months. Of the 12 securities 7 are U.S. government-sponsored agencies and 5 are U.S. Government-sponsored agencies collateralized by residential mortgage obligations. The unrealized losses relate principally to market rate conditions. All of the securities continue to pay as scheduled. When analyzing an issuer's financial condition, management considers the length of time and extent to which the market value has been less than cost; the historical and implied volatility of the security; the financial condition of the issuer of the security; and the Company's intent and ability to hold the security to recovery. As of December 31, 2011, management does not have the intent to sell these securities nor does it believe it is more likely than not that it will be required to sell these securities before the recovery of its amortized cost basis. Based on the Company's evaluation of the above and other relevant factors, the Company does not believe the securities that are in an unrealized loss position as of December 31, 2011 are other than temporarily impaired.

The amortized cost and estimated fair value of investment securities at December 31, 2011 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

	September 30, Amortized Cost	September 30, Estimated Fair Value
After one year through five years	\$ 32,708,000	32,777,000
Investment securities not due at a single maturity date:		
Government-sponsored mortgage-backed securities	24,941,000	25,140,000
	\$ 57,649,000	\$ 57,917,000

Investment securities with amortized costs totaling \$44,878,000 and \$36,828,000 and estimated fair values totaling \$45,149,000 and \$36,814,000 at December 31, 2011 and 2010, respectively, were pledged to secure deposits and repurchase agreements.

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(Continued)

6. LOANS AND THE ALLOWANCE FOR LOAN LOSSES

Outstanding loans are summarized below:

	September 30, December 31, 2011	September 30, 2010
Commercial	\$ 30,235,000	\$ 33,433,000
Agricultural	38,868,000	38,469,000
Real estate residential	39,019,000	43,291,000
Real estate commercial	119,412,000	119,222,000
Real estate construction and land development	17,063,000	31,199,000
Equity lines of credit	37,581,000	36,946,000
Installment	2,515,000	2,879,000
Other	9,172,000	8,761,000
	293,865,000	314,200,000
Deferred loan costs, net	475,000	275,000
Allowance for loan losses	(6,908,000)	(7,324,000)
	\$ 287,432,000	\$ 307,151,000

Changes in the allowance for loan losses were as follows:

	September 30, 2011	September 30, Year Ended December 31, 2010	September 30, 2009
Balance, beginning of year	\$ 7,324,000	\$ 9,568,000	\$ 7,224,000
Provision charged to operations	3,500,000	5,500,000	14,500,000
Losses charged to allowance	(4,247,000)	(8,349,000)	(12,500,000)
Recoveries	331,000	605,000	344,000
Balance, end of year	\$ 6,908,000	\$ 7,324,000	\$ 9,568,000

The recorded investment in impaired loans totaled \$24,402,000 and \$28,755,000 at December 31, 2011 and 2010, respectively. The Company had specific allowances for loan losses of \$2,066,000 on impaired loans of \$14,130,000 at December 31, 2011 as compared to specific allowances for loan losses of \$1,903,000 on impaired loans of \$11,292,000 at December 31, 2010. The balance of impaired loans in which no specific reserves were required totaled \$10,272,000 and \$17,463,000 at December 31, 2011 and 2010, respectively. The average recorded investment in impaired loans for the years ended December 31, 2011, 2010 and 2009 was \$25,536,000, \$20,833,000 and \$25,092,000,

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respectively. The Company recognized \$666,000, \$608,000 and \$369,000 in interest income on a cash basis for impaired loans during the years ended December 31, 2011, 2010 and 2009, respectively.

Included in impaired loans are troubled debt restructurings. A troubled debt restructuring is a formal restructure of a loan where the Company for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concessions may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, and extension of the maturity date.

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(Continued)

6. LOANS AND THE ALLOWANCE FOR LOAN LOSSES (Continued)

The Company has allocated \$1,164,000 and \$271,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2011 and December 31, 2010. The Company has not committed to lend additional amounts on loans classified as troubled debt restructurings at December 31, 2011 and December 31, 2010.

During the year ended December 31, 2011, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 1 month to 2 years. Modifications involving an extension of the maturity date were for periods ranging from 1 month to 10 years.

The following table presents loans by class modified as troubled debt restructurings that occurred during the twelve months ending December 31, 2011:

	September 30, Number of Loans	September 30, Pre-Modification Outstanding Recorded Investment	September 30, Post-Modification Recorded Investment			
Troubled Debt Restructurings:						
Commercial	2	\$ 129,000	\$ 129,000			
Agricultural	4	996,000	996,000			
Real Estate:						
Construction and land development	5	4,977,000	4,977,000			
Equity LOC	1	787,000	787,000			
Other	19	179,000				
Diluted earnings (loss) per share	\$0.01	\$ 0.32	\$ (0.08)	\$ (0.38)	\$ 0.30	
Dividends paid per common share	\$0.10	\$ 0.20	\$ 0.20	\$ 0.20	\$ 0.20	

Selected Operating Ratios(2):

Average yield earned on interest-earning assets	4.42	%	5.08	%	5.64	%	5.75	%	5.92	%
Average rate paid on interest-bearing liabilities	1.58		2.06		2.95		3.73		3.93	
Average interest rate spread(3)	2.84		3.02		2.69		2.02		1.99	
Net interest margin(3)	2.97		3.17		2.97		2.56		2.67	
Average interest-earning assets to average interest-bearing liabilities	109.41		108.04		110.64		116.77		120.64	
Net interest income after provision for loan losses to non-interest	90.55		135.73		117.86		121.60		147.10	

expense

Total non-interest expense to average assets	2.15	2.07	2.17	1.88	1.70
Efficiency ratio(4)	70.83	67.13	92.27	135.31	60.54
Return on average assets	0.02	0.60	(0.16)	(0.89)	0.72
Return on average equity	0.20	5.58	(1.32)	(5.12)	4.01
Average equity to average assets	10.90	10.78	12.28	15.86	18.06

(Footnotes on next page)

	At or For the Year Ended September 30,									
	2011		2010		2009		2008 (1)		2007 (1)	
Asset Quality Ratios(5):										
Non-performing loans as a percent of total loans receivable(6)	5.25	%	1.36	%	0.77	%	1.65	%	1.18	%
Non-performing assets as a percent of total assets(6)	2.98		1.26		1.09		1.13		0.55	
Allowance for loan losses as a percent of non-performing loans	26.63		90.57		137.77		39.42		38.97	
Net charge-offs to average loans receivable	1.90		0.30		0.10		0.21		--	
Capital Ratios(5):										
Tier 1 leverage ratio										
Company	11.06	%	10.27	%	10.86	%	14.49	%	16.99	%
Bank	10.23		9.46		9.99		13.14		15.43	
Tier 1 risk-based capital ratio										
Company	25.54	%	23.12	%	24.59	%	31.20	%	37.69	%
Bank	23.62		21.28		22.61		28.74		34.02	
Total risk-based capital ratio										
Company	26.79	%	24.37	%	25.79	%	31.92	%	38.24	%
Bank	24.87		22.53		23.81		29.46		34.57	

(1) Amounts for 2007 and 2008 were restated during the 2009 period.

(2) With the exception of end of period ratios, all ratios are based on average monthly balances during the indicated periods.

(3) Average interest rate spread represents the difference between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities, and net interest margin represents net interest income as a percentage of average interest-earning assets.

(4) The efficiency ratio represents the ratio of non-interest expense divided by the sum of net interest income and non-interest income.

(5) Asset quality ratios and capital ratios are end of period ratios, except for net charge-offs to average loans receivable.

(6) Non-performing assets consist of non-performing loans and real estate owned. Non-performing loans consist of all loans 90 days or more past due and loans in excess of 90 days delinquent and still accruing interest. It is our policy to cease accruing interest on all loans 90 days or more past due. Real estate owned consists of real estate acquired through foreclosure and real estate acquired by acceptance of a deed-in-lieu of foreclosure.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

At September 30, 2011, we had total assets of \$499.5 million, including \$240.5 million in net loans and \$184.3 million of investment and mortgage-backed securities, total deposits of \$436.0 million and total stockholders' equity of \$57.5 million.

The market dislocations experienced in the financial market beginning in 2007 have continued through 2011. One of the primary sources of the difficulties in the market is the significant declines experienced in the housing market throughout the country. While the Philadelphia area has not suffered the wholesale declines in the value of residential real estate as have other areas of the country, this downturn has rippled through many parts of the local economy, especially condominium sales, construction lending and lending to contractors. The significant deterioration in the 2011 period necessitated large charge-offs and loan loss provision expense.

The Company continues to focus on the credit quality of its customers – closely monitoring the financial status of borrowers throughout the Company's markets, gathering information, working on early detection of potential problems, taking pre-emptive steps where necessary and performing the analysis required to maintain adequate reserves for loan losses.

Despite the current market and economic conditions, the Company continues to maintain capital well in excess of regulatory requirements.

This Management's Discussion and Analysis section is intended to assist in understanding the financial condition and results of operations of Prudential Bancorp. The results of operations of Prudential Bancorp are primarily dependent on the results of the Bank. The information contained in this section should be read in conjunction with our consolidated financial statements and the accompanying notes to the consolidated financial statements contained in Item 8 of this Annual Report on Form 10-K.

Critical Accounting Policies

In reviewing and understanding financial information for Prudential Bancorp, you are encouraged to read and understand the significant accounting policies used in preparing our financial statements. These policies are described in Note 2 of the notes to our consolidated financial statements included in Item 8 hereof. The accounting and financial reporting policies of Prudential Bancorp conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. Accordingly, the financial statements require certain estimates, judgments and assumptions, which are believed to be reasonable, based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities as well as contingent assets and contingent liabilities at the date of the financial statements and the reported amounts of income and expenses during the periods presented. The following accounting policies comprise those that management believes are the most critical to aid in fully understanding and evaluating our reported financial results. These policies require numerous estimates or economic assumptions that may prove inaccurate or may be subject to variations which may significantly affect our reported results and financial condition for the period or in future periods.

Allowance for Loan Losses. The allowance for loan losses is established through a provision for loan losses charged to expense. Losses are charged against the allowance for loan losses when management believes that the collectability in full of the principal of a loan is unlikely. Subsequent recoveries are added to the allowance. The allowance for loan losses is maintained at a level that management considers adequate to provide for estimated losses and impairment based upon an evaluation of known and inherent losses in the loan portfolio that are both probable and reasonable to estimate. Loan impairment is evaluated based on the fair value of collateral or estimated net realizable value. It is the policy of management to provide for losses on unidentified loans in its portfolio in addition to criticized and classified loans.

Management monitors its allowance for loan losses at least quarterly and makes adjustments to the allowance through the provision for loan losses as economic conditions and other pertinent factors indicate. The quarterly review and adjustment of the qualitative factors employed in the allowance methodology and the updating of historic loss experience allow for timely reaction to emerging conditions and trends. In this context, a series of qualitative factors are used in a methodology as a measurement of how current circumstances are affecting the loan portfolio. Included in these qualitative factors are:

- Levels of past due, classified, criticized and non-accrual loans, troubled debt restructurings and modifications;
- Nature and volume of loans;
- Changes in lending policies and procedures, underwriting standards, collections, charge-offs and recoveries and for commercial loans, the level of loans being approved with exceptions to lending policy;
- Experience, ability and depth of management and staff;
- National and local economic and business conditions, including various market segments;
- Quality of the Company's loan review system and degree of Board oversight;
- Concentrations of credit and changes in levels of such concentrations; and
- Effect of external factors on the level of estimated credit losses in the current portfolio.

In determining the allowance for loan losses, management has established both specific and general pooled allowances. Values assigned to the qualitative factors and those developed from historic loss experience provide a dynamic basis for the calculation of reserve factors for both pass-rated loans (general pooled allowance) and those criticized and classified loans. The amount of the specific allowance is determined through a loan-by-loan analysis of certain large dollar commercial loans. Loans not individually reviewed are evaluated as a group using reserve factor percentages based on historic loss experience and the qualitative factors described above. In determining the appropriate level of the general pooled allowance, management makes estimates based on internal risk ratings, which take into account such factors as debt service coverage, loan-to-value ratios, and external factors. Estimates are periodically measured against actual loss experience.

This evaluation is inherently subjective as it requires material estimates including, among others, exposure at default, the amount and timing of expected future cash flows on impaired loans, value of collateral, estimated losses on our commercial, construction and residential loan portfolios and historical loss experience. All of these estimates may be susceptible to significant change.

While management uses the best information available to make loan loss allowance evaluations, adjustments to the allowance may be necessary based on changes in economic and other conditions or changes in accounting guidance. In addition, the Pennsylvania Department of Banking and the FDIC, as an integral part of their examination processes, periodically review our allowance for loan losses. The Pennsylvania Department of Banking and the FDIC may require the recognition of adjustments to the allowance for loan losses based on their judgment of information available to them at the time of their examinations. To the extent that actual outcomes differ from management's estimates, additional provisions to the allowance for loan losses may be required that would adversely impact earnings in future periods.

Investment and mortgage-backed securities available for sale. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated using quoted prices of securities with similar characteristics or discounted cash flows and are classified within Level 2 of the fair value hierarchy. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy, although there were no securities with that classification as of September 30, 2011 or 2010.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company determines whether the unrealized losses are temporary in accordance with United States generally accepted accounting principles (“U.S. GAAP”). The evaluation is based upon factors such as the creditworthiness of the issuers/guarantors, the underlying collateral, if applicable, and the continuing performance of the securities. In addition the Company also considers the likelihood that the security will be required to be sold by a regulatory agency, our internal intent not to dispose of the security prior to maturity and whether the entire cost basis of the security is expected to be recovered. In determining whether the cost basis will be recovered, management evaluates other facts and circumstances that may be indicative of an other-than-temporary impairment condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost, and near-term prospects of the issuer.

In addition, certain assets are measured at fair value on a non-recurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The Company measures impaired loans, FHLB stock and loans or bank properties transferred into real estate owned at fair value on a non-recurring basis.

Valuation techniques and models utilized for measuring financial assets and liabilities are reviewed and validated by the Company at least quarterly.

Income Taxes. The Company accounts for income taxes in accordance with U.S. GAAP. The Company records deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws. If actual results differ from the assumptions and other considerations used in estimating the amount and timing of tax recognized, there can be no assurance that additional expenses will not be required in future periods.

In evaluating our ability to recover deferred tax assets, we consider all available positive and negative evidence, including our past operating results and our forecast of future taxable income. In determining future taxable income, we make assumptions for the amount of taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require us to make judgments about our future taxable income and are consistent with the plans and estimates we use to manage our business. Any reduction in estimated future taxable income may require us to record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the period and could have a significant impact on our future earnings.

U.S. GAAP prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the consolidated income statement. Assessment of uncertain tax positions requires careful consideration of the technical merits of a position based on management's analysis of tax regulations and interpretations. Significant judgment may be involved in the assessment of the tax position.

Recent Accounting Pronouncements

The information required by this item is included in Note 2 to the Consolidated Financial Statements set forth in Item 8 hereto.

Derivative Financial Instruments, Contractual Obligations and Other Off Balance Sheet Arrangements. Derivative financial instruments include futures, forwards, interest rate swaps, option contracts, and other financial instruments with similar characteristics. We have not used derivative financial instruments in the past and do not currently have any intent to do so in the future.

While we have not used derivative financial instruments, we are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and the unused portions of lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. Commitments to extend credit generally have fixed expiration dates and may require additional collateral from the borrower if deemed necessary. Commitments to extend credit are not recorded as an asset or liability by us until the instrument is exercised.

Commitments

The following tables summarize our outstanding commitments to originate loans and to advance additional amounts pursuant to outstanding letters of credit, lines of credit and undisbursed construction loans at September 30, 2011.

	Total Amounts Committed (In Thousands)	Amount of Commitment Expiration - Per Period			
		To 1 Year	1-3 Years	4-5 Years	After 5 Years
Letters of credit	\$676	\$676	\$-	\$-	\$-
Lines of credit (1)	7,806	-	-	-	7,806
Undisbursed portions of loans in process (2)	3,773	1,709	946	1,118	-
Commitments to originate loans	7,178	7,178	-	-	-
Total commitments	\$19,433	\$9,563	\$946	\$1,118	\$7,806

(1) The majority of available lines of credit are for home equity loans.

(2) Includes participation interests sold to other financial institutions totaling \$118,000; Prudential Savings Bank will fund such amount and be reimbursed by the participants.

Contractual Cash Obligations

The following table summarizes our contractual cash obligations at September 30, 2011.

	Total	To 1 Year	Payments Due By Period		After 5 Years
			1-3 Years	4-5 Years	
			(In Thousands)		
Certificates of deposit	\$ 256,237	\$ 121,984	\$ 105,863	\$ 28,390	\$ -
FHLB advances(1)	570	64	166	340	-
Total long-term debt	256,807	122,048	106,029	28,730	-
Advances from borrowers for taxes and insurance	1,090	1,090	-	-	-
Operating lease obligations	286	78	156	52	-
Total contractual obligations	\$ 258,183	\$ 123,216	\$ 106,185	\$ 28,782	\$ -

(1) Does not include interest due annually on FHLB advances.

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Average Balances, Net Interest Income, and Yields Earned and Rates Paid. The following table shows for the periods indicated the total dollar amount of interest from average interest-earning assets and the resulting yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates, and the net interest margin. Tax-exempt income and yields have not been adjusted to a tax-equivalent basis. All average balances are based on monthly balances. Management does not believe that the monthly averages differ significantly from what the daily averages would be.

	Year Ended September 30,										
	2011		2010		2009		2008		2007		2006
	Yield/Rate at September 30, 2011	Average Balance	Average Interest	Average Yield/ Rate(1)	Average Balance	Average Interest	Average Yield/ Rate	Average Balance	Average Interest	Average Yield/ Rate	Average Balance
(Dollars in Thousands)											
Interest-earning assets:											
Investment securities	2.74%	\$107,065	\$3,569	3.33%	\$117,655	\$5,431	4.62%	\$126,922	\$6,189	4.88%	\$136,311
Mortgage-backed securities	4.55%	89,666	4,300	4.80%	92,294	4,721	5.12%	92,676	5,907	6.37%	92,676
Loans receivable(1)	5.50%	246,188	13,724	5.57%	254,781	14,914	5.85%	253,278	15,168	5.99%	253,278
Other interest-earning assets	0.25%	47,918	92	0.19%	29,543	43	0.15%	12,783	122	0.95%	12,783
Total interest-earning assets	4.21%	490,837	21,685	4.42%	494,273	25,109	5.08%	485,659	27,386	5.64%	485,659
Non-interest-earning assets		21,210			26,092			23,572			23,572
Total assets		\$512,047			\$520,365			\$509,231			\$509,231
Interest-bearing liabilities:											
Savings accounts	0.29%	\$69,741	\$695	1.00%	\$69,363	\$1,224	1.76%	\$65,392	\$1,525	2.33%	\$65,392
Checking and money market accounts	0.61%	105,046	779	0.74%	105,724	1,119	1.06%	96,806	1,863	1.92%	96,806
Certificate accounts	2.06%	271,758	5,612	2.07%	264,082	6,321	2.39%	247,791	8,585	3.46%	247,791
Total deposits	1.44%	446,545	7,086	1.59%	439,169	8,664	1.97%	409,989	11,973	2.92%	409,989
FHLB advances	1.02%	591	6	1.02%	16,676	746	4.47%	27,243	962	3.53%	27,243
Real estate tax escrow accounts	0.25%	1,477	5	0.34%	1,638	6	0.37%	1,740	7	0.40%	1,740
Other interest-bearing liabilities	-	-	-	-	-	-	-	-	-	-	-
Total interest-bearing liabilities	1.44%	448,613	7,097	1.58%	457,483	9,416	2.06%	438,972	12,942	2.95%	438,972
		7,624			6,794			7,712			7,712

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Non-interest-bearing liabilities									
Total liabilities	456,237			464,277				446,684	
Stockholders' Equity	55,810			56,088				62,547	
Total liabilities and Stockholders' Equity	\$512,047			\$520,365				\$509,231	
Net interest-earning assets	\$42,224			\$36,790				\$46,687	
Net interest income; interest rate spread	2.77%	\$14,588	2.84 %	\$15,693	3.02 %			\$14,444	2.69 %
Net interest margin (2)			2.97 %		3.17 %				2.97 %
Average interest-earning assets to average interest-bearing liabilities			109.41 %		108.04 %				110.64 %

(1) Includes nonaccrual loans during the respective periods. Calculated net of deferred fees and discounts, loans in process and allowance for loan losses.

(2) Equals net interest income divided by average interest-earning assets.

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Rate/Volume Analysis. The following table shows the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities affected our interest income and expense during the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate, which is the change in rate multiplied by prior year volume, and (2) changes in volume, which is the change in volume multiplied by prior year rate. The combined effect of changes in both rate and volume has been allocated proportionately to the change due to rate and the change due to volume.

	2011 vs. 2010			Total Increase (Decrease) (In Thousands)	2010 vs. 2009			Total Increase (Decrease)
	Increase (Decrease) Due to		Rate/ Volume		Increase (Decrease) Due to		Rate/ Volume	
	Rate	Volume			Rate	Volume		
Interest income:								
Investment securities	\$(1,509)	\$(489)	\$135	\$(1,863)	\$(330)	\$(452)	\$24	\$(758)
Mortgage-backed securities	(295)	(134)	8	(421)	(1,166)	(24)	4	(1,186)
Loans receivable, net	(711)	(503)	24	(1,190)	(342)	90	(2)	(254)
Other interest-earning assets	14	27	9	50	(103)	160	(136)	(79)
Total interest income	(2,501)	(1,099)	176	(3,424)	(1,941)	(226)	(110)	(2,277)
Interest expense:								
Savings accounts	(533)	7	(3)	(529)	(371)	93	(23)	(301)
Checking accounts (interest-bearing and non-interest bearing)	(335)	(7)	2	(340)	(838)	172	(78)	(744)
Certificate accounts	(868)	184	(25)	(709)	(2,654)	564	(174)	(2,264)
Total deposits	(1,736)	184	(26)	(1,578)	(3,863)	829	(275)	(3,309)
FHLB advances	(577)	(720)	557	(740)	257	(373)	(100)	(216)
Other interest-bearing liabilities	-	(1)	-	(1)	(1)	-	-	(1)
Total interest expense	(2,313)	(537)	531	(2,319)	(3,607)	456	(375)	(3,526)
Increase (decrease) in net interest income	\$(188)	\$(562)	\$(355)	\$(1,105)	\$1,666	\$(682)	\$265	\$1,249

Comparison of Financial Condition at September 30, 2011 and September 30, 2010

At September 30, 2011, the Company had total assets of \$499.5 million, a decrease of \$29.5 million from \$529.1 million at September 30, 2010. The decrease was primarily attributable to decreases of \$12.7 million in cash and cash equivalents and \$14.6 million in net loans during fiscal 2011. The decline in the loan portfolio reflected in large part the \$18.4 million decline in the construction and land development loan portfolio due in part to Prudential Bancorp's efforts to reduce its exposure in this line of lending in response to the continued deterioration of the real estate market in the Philadelphia area as well as the charge-offs taken during fiscal 2011.

Total liabilities decreased \$30.0 million to \$442.1 million at September 30, 2011 from \$472.1 million at September 30, 2010. The decrease was primarily the result of a \$28.4 million decrease in deposits, primarily certificates of deposit, as we have priced certificates at a level to achieve a balance between maintaining the desired level of liquidity and monitoring our interest rate spread and margin.

Stockholders' equity increased by \$453,000 to \$57.5 million at September 30, 2011 from \$57.0 million at September 30, 2010. The increase reflected the effect of vesting associated with the Company's stock benefit plans of \$774,000 combined with an increase in the market value of available for sale securities, net of tax, of \$581,000 and the recognition of net income of \$112,000. These increases were partially offset by payment of dividends totaling \$964,000 during the first two quarters of fiscal 2011.

Comparison of Operating Results for the Year Ended September 30, 2011 and September 30, 2010

General. For the fiscal year ended September 30, 2011, the Company recognized net income of \$112,000 as compared to net income of \$3.1 million for the year ended September 30, 2010. The reduction in earnings experienced for the fiscal year ended September 30, 2011 was due primarily to a substantial increase in the loan loss provision established during the second quarter of fiscal 2011 as declines in the collateral values related to two significant construction loans were recognized requiring significant provisions for loan losses to be established.

Net Interest Income. For the year ended September 30, 2011, net interest income decreased \$1.1 million or 7.0% to \$14.6 million as compared to \$15.7 million for fiscal 2010. The decrease was due to a \$3.4 million or 13.6% decrease in interest income partially offset by a \$2.3 million or 24.6% decrease in interest expense. The decrease in interest income resulted primarily from a 66 basis point decrease to 4.42% in the weighted average yield earned on interest-earning assets. Also contributing to the decrease was a \$3.4 million or 0.7% decrease in the average balance of interest-earning assets. The majority of the decline in the weighted average yield reflected the 129 basis point decline in the yield earned on the investment portfolio due to the reinvestment of the proceeds received from called investment securities at lower current market rates. The decrease in interest expense resulted from a 48 basis point decrease to 1.58% in the weighted average rate paid on interest-bearing liabilities. Also contributing to the decrease was an \$8.9 million or 1.9% decrease in the average balance of interest-bearing liabilities for the year ended September 30, 2011, primarily due to the decline in FHLB advances, as compared to fiscal 2010.

Provision for Loan Losses. For the year ended September 30, 2011, the Company established a \$4.6 million provision for loan losses as compared to \$1.1 million for fiscal 2010. The increased level of provisions in the year ended September 30, 2011 reflected primarily the provisions established in connection with the recognition of declines in the value of collateral securing two construction development projects. In addition, the level of the provisions reflected management's ongoing review of the loan portfolio. As a result of the increased charge-offs experienced during the first half of fiscal 2011 which related primarily to the two construction development projects, the increased level of non-performing loans and the continued deterioration of real estate values in the Company's market area, management determined a significant additional provision was appropriate in the second quarter of fiscal 2011. The first project involves a \$4.3 million construction loan secured by a 33-unit condominium project in Philadelphia. During the second quarter of fiscal 2011, due to the lack of recent sales in the project combined with deterioration in real estate values in the market, in particular for condominiums, the Company made a determination to utilize the "bulk sale" appraised value of the remaining units in the project rather than the retail value. This re-evaluation resulted in a charge-off of \$2.6 million during the second quarter of fiscal 2011 of which \$1.9 million was recognized as provision expense for the quarter ended March 31, 2011. An additional charge-off of \$241,000 was recognized on this project during the quarter ended September 30, 2011 as a subsequent appraisal indicated a further decline in value. The second project involves an aggregate of \$1.8 million in loans secured by the seven unsold units associated with a 17-unit townhouse project in Philadelphia. Based on both the decline in the value of the collateral securing the project and the lack of sales, Prudential Bancorp determined to charge off \$1.5 million of which \$1.1 million was recognized as provision expense during the quarter ended March 31, 2011. The allowance for loan losses totaled \$3.4 million, or 1.4% of total loans and 26.6% of non-performing loans at September 30, 2011.

Non-interest income. Non-interest income amounted to \$938,000 for the year ended September 30, 2011, compared with \$387,000 for fiscal 2010. The improvement compared to fiscal 2010 was due to the reduced level of other than temporary impairment (“OTTI”) charges related to non-agency mortgage securities received in connection with the Company’s redemption in kind of its entire investment in a mutual fund. The decline in the amount of losses recognized between the 2010 and 2011 periods reflected the decline in the amount of the OTTI related to the non-agency mortgage-backed securities as the markets for such securities stabilized in the 2011 periods. Also contributing to the increase in the quarter and year ended September 30, 2011 was the receipt of \$260,000 received in conjunction with the settlement of litigation in which the Company was a plaintiff.

Non-interest Expense. For the year ended September 30, 2011, non-interest expense increased \$202,000 to \$11.0 million for the year ended September 30, 2011 compared to fiscal 2010. The increase was primarily due to increases in salaries and employee benefits expense.

Income Tax Expense. The Company recorded an income tax benefit of \$212,000 for the year ended September 30, 2011 compared to income tax expense of \$1.0 million for the year ended September 30, 2010. Income tax expense decreased in the 2011 periods in part due to the reduction in the valuation allowance recognized related to the capital loss carryforward created in connection with the mutual fund redemption in kind referenced above.

Liquidity and Capital Resources

The liquidity of the Company is the ability to maintain cash flows that are adequate to fund operations and meet its other obligations on a timely and cost effective basis in various market conditions. The ability of the Company to meet its current financial obligations is a function of balance sheet structure, the ability to liquidate assets and the availability of alternative sources of funds. To meet the needs of the clients and manage the risk of the Company, the Company engages in liquidity planning and management.

Our primary sources of funds are from deposits, scheduled principal and interest payments on loans, loan prepayments and the maturity of loans, mortgage-backed securities and other investments, and other funds provided from operations. While scheduled payments from the amortization of loans and mortgage-backed securities and maturing investment securities are relatively predictable sources of funds, deposit flows and loan prepayments can be greatly influenced by general interest rates, economic conditions and competition. We also maintain excess funds in short-term, interest-bearing assets that provide additional liquidity. At September 30, 2011, our cash and cash equivalents amounted to \$53.8 million. In addition, our available for sale investment and mortgage-backed securities amounted to an aggregate of \$75.4 million at September 30, 2011.

We use our liquidity to fund existing and future loan commitments, to fund maturing certificates of deposit and demand deposit withdrawals, to invest in other interest-earning assets, and to meet operating expenses. At September 30, 2011, we had certificates of deposit maturing within the next 12 months amounting to \$122.0 million. Based upon historical experience, we anticipate that a significant portion of the maturing certificates of deposit will be redeposited with us unless we determine to lower rates to below competition in order to facilitate the reduction of higher cost deposits during periods when there is excess cash on hand or in order to satisfy our asset/liability goals. There were no deposits as of September 30, 2011 requiring the pledging of collateral.

In addition to cash flows from loan and securities payments and prepayments as well as from sales of available for sale securities, we have significant borrowing capacity available to fund liquidity needs should the need arise. Our borrowings consist solely of advances from the Federal Home Loan Bank of Pittsburgh, of which we are a member. Under terms of the collateral agreement with the Federal Home Loan Bank, we pledge residential mortgage loans as well as our stock in the Federal Home Loan Bank as collateral for such advances. At September 30, 2011, we had \$570,000 in outstanding FHLB advances and we had the ability to borrow up to \$123.1 million in additional FHLB advances. A borrowing line of credit has also been established with the Federal Reserve Bank. In addition, the Company has the ability to generate brokered certificates of deposit.

Upon review of its capital position and business operations, the Company has chosen to repurchase a significant amount of its capital stock in order to enhance shareholder value. As of September 30, 2011 the Company has repurchased 2,540,255 shares, or \$31.6 million in treasury stock since May 2005. However, no purchases have been affected since the quarter ended March 31, 2011 in order to preserve capital in light of the Company's asset quality situation.

We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

Impact of Inflation and Changing Prices

The consolidated financial statements, accompanying notes, and related financial data of Prudential Bancorp presented in Item 8, Financial Statements and Supplementary Data, in Part II of this Annual Report on Form 10-K have been prepared in accordance with U.S. GAAP, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of operations. Most of our assets and liabilities are monetary in nature; therefore, the impact of interest rates has a greater impact on our performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Exposure to Changes in Interest Rates

Gap Analysis. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring the Bank's interest rate sensitivity "gap." An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that same time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to affect adversely net interest income while a positive gap would tend to result in an increase in net interest income. Conversely, during a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to affect adversely net interest income.

The table on the next page sets forth the amounts of our interest-earning assets and interest-bearing liabilities outstanding at September 30, 2011, which we expect, based upon certain assumptions, to reprice or mature in each of the future time periods shown (the "GAP Table"). Except as stated below, the amounts of assets and liabilities shown which reprice or mature during a particular period were determined in accordance with the earlier of term to repricing or the contractual maturity of the asset or liability. The table sets forth an approximation of the projected repricing of assets and liabilities at September 30, 2011, on the basis of contractual maturities, anticipated prepayments, and scheduled rate adjustments within a three-month period and subsequent selected time intervals. The loan amounts in the table reflect principal balances expected to be redeployed and/or repriced as a result of contractual amortization and anticipated prepayments of adjustable-rate loans and fixed-rate loans, and as a result of contractual rate adjustments on adjustable-rate loans. Annual prepayment rates for adjustable-rate and fixed-rate single-family and multi-family residential and commercial mortgage loans are assumed to range from 5.5% to 24.5%. The annual prepayment rate for mortgage-backed securities is assumed to range from 0.4% to 28.6%. Money market deposit accounts, savings accounts and interest-bearing checking accounts are assumed to have annual rates of withdrawal, or "decay rates," based on information from an internal analysis of our accounts up to a maximum of ten years.

	3 Months or Less	More than 3 Months to 1 Year	More than 1 Year to 3 Years	More than 3 Years to 5 Years	More than 5 Years	Total Amount
Interest-earning assets(1):						
Investment and mortgage-backed securities	\$ 25,075	\$ 28,066	\$ 27,722	\$ 19,226	\$ 80,823	\$ 180,912
Loans receivable(2)	28,440	45,931	88,728	42,142	38,070	243,311
Other interest-earning assets (3)	53,908	-	-	-	-	53,908
Total interest-earning assets	\$ 107,423	\$ 73,997	\$ 116,450	\$ 61,368	\$ 118,893	\$ 478,131
Interest-bearing liabilities:						
Savings accounts	2,164	4,817	9,465	8,685	45,465	70,596
Checking and money market accounts	4,126	12,380	24,661	18,365	45,801	105,333
Certificate accounts	27,453	94,532	105,863	28,390	-	256,238
FHLB advances	59	158	13	340	-	570
Real estate tax escrow accounts	1,090	-	-	-	-	1,090
Other interest-bearing liabilities						
Total interest-bearing liabilities	\$ 34,892	\$ 111,887	\$ 140,002	\$ 55,780	\$ 91,266	\$ 433,827
Interest-earning assets less interest-bearing liabilities	\$ 72,531	(\$ 37,890)	(\$ 23,552)	\$ 5,588	\$ 27,627	\$ 44,304
Cumulative interest-rate sensitivity gap(4)	\$ 72,531	\$ 34,641	\$ 11,089	\$ 16,677	\$ 44,304	
	14.52 %	6.93 %	2.22 %	3.34 %	8.87 %	

Cumulative
interest-rate gap as a
percentage of total assets at
September 30, 2011

Cumulative
interest-earning assets as a
percentage of cumulative
interest-bearing liabilities
at September 30, 2011

307.87 %	123.60 %	103.87 %	104.87 %	110.21 %
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- (1) Interest-earning assets are included in the period in which the balances are expected to be redeployed and/or repriced as a result of anticipated prepayments, scheduled rate adjustments and contractual maturities.
- (2) For purposes of the gap analysis, loans receivable includes non-performing loans, gross of the allowance for loan losses, undisbursed loan funds, unamortized discounts and deferred loan fees.
- (3) Includes FHLB stock.
- (4) Interest-rate sensitivity gap represents the difference between total interest-earning assets and total interest-bearing liabilities.

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate loans, have features which restrict changes in interest rates both on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. Finally, the ability of many borrowers to service their adjustable-rate loans may decrease in the event of an interest rate increase.

Net Portfolio Value Analysis. Our interest rate sensitivity also is monitored by management through the use of a model which generates estimates of the changes in our net portfolio value (“NPV”) over a range of interest rate scenarios. NPV is the present value of expected cash flows from assets, liabilities and off-balance sheet contracts. The NPV ratio, under any interest rate scenario, is defined as the NPV in that scenario divided by the market value of assets in the same scenario. The following table sets forth our NPV as of September 30, 2011 and reflects the changes to NPV as a result of immediate and sustained changes in interest rates as indicated.

Change in Interest Rates In Basis Points (Rate Shock)	Net Portfolio Value		NPV as % of Portfolio Value of Assets			
	Amount	\$ Change	% Change	NPV Ratio	Change	
	(Dollars in Thousands)					
300	\$ 53,216	\$ (27,781)	-34.30 %	11.70 %	-4.15 %	
200	\$ 64,550	\$ (16,447)	-20.31 %	13.59 %	-2.26 %	
100	\$ 76,327	\$ (4,670)	-5.77 %	15.38 %	-0.47 %	
Static	\$ 80,997	\$ -	---	15.85 %	---	
(100)	\$ 77,049	\$ (3,948)	-4.87 %	14.92 %	-0.93 %	
(200)	\$ 76,959	\$ (4,038)	-4.99 %	14.73 %	-1.12 %	
(300)	\$ 79,151	\$ (1,846)	-2.28 %	14.95 %	-0.90 %	

At September 30, 2010, the Company’s NPV was \$80.3 million or 14.86% of the market value of assets. Following a 200 basis point increase in interest rates, the Company’s “post shock” NPV would be \$71.0 million or 12.28% of the market value of assets. The change in the NPV ratio or Company’s sensitivity measure was an increase of 258 basis points.

As is the case with the GAP Table, certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV require the making of certain assumptions which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the models presented assume that the composition of our interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the NPV model provides an indication of interest rate risk exposure at a particular point in time, such model is not intended to and does not provide a precise forecast of the effect of changes in market interest rates on net interest income and will differ from actual results.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

See Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Exposure to Changes in Interest Rates.”

Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Prudential Bancorp, Inc. of Pennsylvania

We have audited the accompanying consolidated statements of financial condition of Prudential Bancorp, Inc. of Pennsylvania (the "Company") and subsidiary as of September 30, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity, and comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and subsidiary as of September 30, 2011 and 2010, and the results of their operations and cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ S.R. Snodgrass, A.C.

Wexford, PA
December 23, 2011

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	September 30, 2011 2010 (Dollars in Thousands)	
ASSETS		
Cash and amounts due from depository institutions	\$2,808	\$3,649
Interest-bearing deposits	51,021	62,875
Total cash and cash equivalents	53,829	66,524
Investment and mortgage-backed securities available for sale (amortized cost—September 30, 2011, \$71,955; September 30, 2010, \$69,891)	75,370	72,425
Investment and mortgage-backed securities held to maturity (fair value—September 30, 2011, \$112,721; September 30, 2010, \$116,594)	108,956	112,673
Loans receivable—net of allowance for loan losses (September 30, 2011, \$3,364; September 30, 2010, \$3,151)	240,511	255,091
Accrued interest receivable	2,026	2,669
Real estate owned	2,268	3,197
Federal Home Loan Bank stock—at cost	2,887	3,545
Office properties and equipment—net	1,816	2,069
Bank owned life insurance	6,180	5,990
Deferred income taxes, net	3,211	1,762
Prepaid expenses and other assets	2,483	3,135
TOTAL ASSETS	\$499,537	\$529,080

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES:

Deposits:

Non-interest-bearing	\$3,847	\$2,570
Interest-bearing	432,167	461,885
Total deposits	436,014	464,455
Advances from Federal Home Loan Bank	570	615
Accrued interest payable	2,420	3,361
Advances from borrowers for taxes and insurance	1,090	1,115
Accrued dividend payable	-	502
Accounts payable and accrued expenses	1,991	2,033
Total liabilities	442,085	472,081

COMMITMENTS AND CONTINGENCIES (Note 12)

STOCKHOLDERS' EQUITY:

Preferred stock, \$.01 par value, 10,000,000 shares authorized; none issued	-	-
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Common stock, \$.01 par value, 40,000,000 shares authorized; issued 12,563,750; outstanding - 10,023,495 at September 30, 2011; 10,031,472 at September 30, 2010	126	126
Additional paid-in capital	54,078	53,528
Unearned Employee Stock Ownership Plan (“ESOP”) shares	(3,011)	(3,234)
Treasury stock, at cost: 2,540,255 shares at September 30, 2011; 2,532,278 shares at September 30, 2010	(31,625)	(31,576)
Retained earnings (substantially restricted)	35,631	36,483
Accumulated other comprehensive income	2,253	1,672
Total stockholders’ equity	57,452	56,999
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	\$499,537	\$529,080

See notes to consolidated financial statements.

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended September 30,	
	2011	2010
	(Dollars in Thousands Except Per Share Amounts)	
INTEREST INCOME:		
Interest and fees on loans	\$ 13,724	\$ 14,914
Interest on mortgage-backed securities	4,300	4,721
Interest and dividends on investments	3,569	5,431
Interest on interest-bearing deposits	92	43
Total interest income	21,685	25,109
INTEREST EXPENSE:		
Interest on deposits	7,091	8,670
Interest on borrowings	6	746
Total interest expense	7,097	9,416
NET INTEREST INCOME	14,588	15,693
PROVISION FOR LOAN LOSSES	4,630	1,110
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,958	14,583
NON-INTEREST INCOME:		
Gain on sale of mortgage-backed securities available for sale	15	-
Fees and other service charges	459	493
Total other-than-temporary impairment losses	(277)	(597)
Portion of loss recognized in other comprehensive income, before taxes	73	37
Net impairment losses recognized in earnings	(204)	(560)
Other	668	454
Total non-interest income	938	387
NON-INTEREST EXPENSES:		
Salaries and employee benefits	5,607	5,430
Data processing	459	505
Professional services	716	649
Office occupancy	396	402
Depreciation	342	355
Payroll taxes	280	279

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Director compensation	308		296
Federal Deposit Insurance Corporation premiums	850		809
Real estate owned expense	298		414
Other	1,740		1,655
Total non-interest expenses	10,996		10,794
(LOSS) INCOME BEFORE INCOME TAXES	(100)	4,176
INCOME TAXES:			
Current	1,536		1,528
Deferred benefit	(1,748)	(482
Total	(212)	1,046
NET INCOME	\$	112	\$ 3,130
BASIC INCOME PER SHARE	\$	0.01	\$ 0.33
DILUTED INCOME PER SHARE	\$	0.01	\$ 0.32
DIVIDENDS PER SHARE	\$	0.10	\$ 0.20

See notes to consolidated financial statements.

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME

	Common Stock	Additional Paid-In Capital	Unearned ESOP Shares	Treasury Stock (Dollars in Thousands)	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity	Comprehensive Income
BALANCE, SEPTEMBER 30, 2009	\$126	\$52,938	\$(3,457)	\$(28,652)	\$35,293	\$ (391)	\$ 55,857	
Comprehensive income:								
Net income					3,130		3,130	\$ 3,130
Net unrealized holding gain on available for sale securities arising during the period, net of income tax \$872						1,693	1,693	1,693
Reclassification adjustment for other than temporary impairment recognized in earnings net of tax of \$190						370	370	370
Comprehensive income								\$ 5,193
Cash dividends (\$0.20 per share)					(1,940)		(1,940)	
Treasury stock purchased (300,394 shares)				(2,924)			(2,924)	
Execss tax benefit from stock		109					109	

compensation

Stock option
expense

218

218

Recognition and
Retention Plan
expense

300

300

ESOP shares
committed to be
released (22,620
shares)

(37) 223

186

BALANCE,
SEPTEMBER 30,
2010

\$126

\$ 53,528

\$(3,234)

\$(31,576)

\$36,483

\$ 1,672

\$ 56,999

Comprehensive
income:

Net income

112

112

112

Net unrealized
holding gain on
available for sale
securities arising
during the period,
net of income tax
\$230

456

456

456

Reclassification
adjustment for gains
recognized in
earnings net of tax
benefit of \$5

(10)

(10)

(10)

Reclassification
adjustment for other
than temporary
impairment
recognized in
earnings net of tax
of \$69

135

135

135

Comprehensive
income

\$ 693

Cash dividends
(\$0.10 per share)

(964)

(964)

Treasury stock purchased (7,977 shares)			(49)				(49)
Execss tax benefit from stock compensation	95						95
Stock option expense	220						220
Recognition and Retention Plan expense	319						319
ESOP shares committed to be released (22,620 shares)	(84)	223					139
BALANCE, SEPTEMBER 30, 2011	\$126	\$ 54,078	\$(3,011)	\$(31,625)	\$35,631	\$ 2,253	\$ 57,452

See notes to consolidated financial statements

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

STATEMENTS OF CASH FLOWS

	Years Ended September 30,	
	2011	2010
	(Dollars in Thousands)	
OPERATING ACTIVITIES:		
Net income	\$112	\$3,130
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	4,630	1,110
Depreciation	342	355
Net accretion of premiums/discounts	(334)	(407)
Income from bank owned life insurance	(190)	(204)
Accretion of deferred loan fees	(122)	(148)
Compensation expense of ESOP	139	186
Loss on sale of real estate owned	135	-
Gain on sale of mortgage-backed securities	(15)	-
Impairment charge on investment and mortgage-backed securities	204	560
Impairment charge on real estate owned	77	18
Share-based compensation expense	634	627
Deferred income tax benefit	(1,748)	(482)
Excess tax benefit related to stock compensation	(95)	(109)
Changes in assets and liabilities which (used) provided cash:		
Accounts payable and accrued expenses	(42)	330
Accrued interest payable	(941)	(102)
Prepaid expenses and other assets	652	(1,855)
Accrued interest receivable	643	636
Net cash provided by operating activities	4,081	3,645
INVESTING ACTIVITIES:		
Purchase of investment and mortgage-backed securities held to maturity	(106,956)	(62,986)
Purchase of investment and mortgage-backed securities available for sale	(24,609)	(23,845)
Principal collected on loans	52,914	52,456
Principal payments received on investment and mortgage-backed securities:		
Held-to-maturity	110,702	110,483
Available for sale	22,555	16,748
Loans originated or acquired	(43,303)	(53,507)
Proceeds from redemption of Federal Home Loan Bank stock	658	-
Proceeds from sale of mortgage-backed securities	105	-
Proceeds from sale of real estate owned	1,178	2,100
Purchases of equipment	(89)	(433)
Net cash provided by investing activities	13,155	41,016
FINANCING ACTIVITIES:		
Net increase in demand deposits, NOW accounts, and savings accounts	5,412	2,178
Net (decrease) increase in certificates of deposit	(33,853)	29,903
Repayment of borrowing from Federal Home Loan Bank	(45)	(19,044)
Decrease in advances from borrowers for taxes and insurance	(25)	(99)
Cash dividends paid	(1,466)	(1,929)

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Excess tax benefit related to stock compensation	95	109
Purchase of treasury stock	(49)	(2,924)
Net cash (used in) provided by financing activities	(29,931)	8,194
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(12,695)	52,855
CASH AND CASH EQUIVALENTS—Beginning of year	66,524	13,669
CASH AND CASH EQUIVALENTS—End of year	\$53,829	\$66,524
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid on deposits and advances from Federal Home Loan Bank	\$8,038	\$9,518
Income taxes paid	\$1,325	\$1,631
SUPPLEMENTAL DISCLOSURES OF NONCASH ITEMS:		
Real estate acquired in settlement of loans	\$461	\$1,692

See notes to consolidated financial statements.

PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Prudential Bancorp, Inc. of Pennsylvania (the “Company”) is a Pennsylvania corporation, which was organized to be the mid-tier holding company for Prudential Savings Bank (the “Bank”), which is a Pennsylvania-chartered, FDIC-insured savings bank with seven full service branches in the Philadelphia area. The Bank’s primary federal banking regulator is the Federal Deposit Insurance Corporation. The Bank is principally in the business of attracting deposits from its community through its branch offices and investing those deposits, together with funds from borrowings and operations, primarily in single-family residential loans. The Bank’s sole subsidiary as of September 30, 2011 was PSB Delaware, Inc. (“PSB”), a Delaware-chartered company established to hold certain investments. As of September 30, 2011, PSB had assets of \$106.2 million primarily consisting of investment and mortgage-backed securities.

The Company’s primary market area is Philadelphia, in particular South Philadelphia and Center City, as well as Delaware County. The Company also conducts business in Bucks, Chester and Montgomery Counties which, along with Delaware County, comprise the suburbs of Philadelphia.

Prudential Mutual Holding Company (the “MHC”), a Pennsylvania corporation, is the mutual holding company parent of the Company. As of September 30, 2011, Prudential Mutual Holding Company owned 74.6% (7,478,062 shares) of the Company’s outstanding common stock and must always own at least a majority of the voting stock of the Company. In addition to the 6,910,062 shares of the Company received in connection with the reorganization in March 2005, the MHC was concurrently therewith initially capitalized with \$100,000 in cash from the Bank. Subsequent to the completion of the reorganization, the MHC has purchased 568,000 shares of the Company’s common stock from other shareholders.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation –The accompanying consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates in the Preparation of Financial Statements—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“US GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. The most significant estimates and assumptions in the Company’s financial statements are recorded in the allowance for loan losses, the fair value of financial instruments, other than temporary impairment of securities and valuation of deferred tax assets. Actual results could differ from those estimates.

Cash and Cash Equivalents—For purposes of reporting cash flows, cash and cash equivalents include cash and amounts due from depository institutions and interest-bearing deposits with original maturities of less than 90 days.

Investment Securities and Mortgage-Backed Securities—The Company classifies and accounts for debt and equity securities as follows:

Held to Maturity—Debt securities that management has the positive intent and ability to hold until maturity are classified as held to maturity and are carried at their remaining unpaid principal balance, net of unamortized premiums or unaccreted discounts. Premiums are amortized and discounts are accreted using the interest method over the estimated remaining term of the underlying security.

Available for Sale—Debt and equity securities that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity, and changes in the availability and the yield of alternative investments, are classified as available for sale. These assets are carried at fair value. Fair value is determined using public market prices, dealer quotes, and prices obtained from independent pricing services that may be derivable from observable and unobservable market inputs. Unrealized gains and losses are excluded from earnings and are reported net of tax as a separate component of stockholders' equity until realized. Realized gains or losses on the sale of investment and mortgage-backed securities are reported in earnings as of the trade date and determined using the adjusted cost of the specific security sold.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. For all securities that are in an unrealized loss position for an extended period of time and for all securities whose fair value is significantly below amortized cost, the Company performs an evaluation of the specific events attributable to the market decline of the security. The Company considers the length of time and extent to which the security's market value has been below cost as well as the general market conditions, industry characteristics, and the fundamental operating results of the issuer to determine if the decline is other-than-temporary. The Company also considers as part of the evaluation its intention whether or not to sell the security until its market value has recovered to a level at least equal to the amortized cost. When the Company determines that a security's unrealized loss is other-than-temporary, a realized loss is recognized in the period in which the decline in value is determined to be other-than-temporary. The write-down is measured based on public market prices of the security at the time the Company determines the decline in value was other-than-temporary.

Loans Receivable— Lending consists of various loan types including single-family residential mortgage loans, construction and land development loans, non-residential or commercial real estate mortgage loans, home equity loans and lines of credit, commercial business loans, and consumer loans and are stated at their unpaid principal balances net of unamortized net fees/costs. Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balance adjusted for unearned income, the allowance for loan losses and any unamortized deferred fees or costs. The Company defers all loan fees, net of certain direct loan origination costs. The balance is accreted into interest income as a yield adjustment over the life of the loan using the interest method.

Loan Origination and Commitment Fees—The Company defers loan origination and commitment fees, net of certain direct loan origination costs. The balance is accreted into income as a yield adjustment over the life of the loan using the level-yield method.

Interest on Loans—The Company recognizes interest on loans on the accrual basis. Income recognition is generally discontinued when a loan becomes 90 days or more delinquent. Any interest previously accrued is deducted from interest income. Such interest ultimately collected is credited to income when loans are no longer 90 days or more delinquent.

Allowance for Loan Losses— The allowance for loan losses represents the amount which management estimates is adequate to provide for probable losses inherent in its loan portfolio as of the Consolidated Statement of Financial Condition date. The allowance method is used in providing for loan losses. Accordingly, all loan losses are charged to the allowance, and all recoveries are credited to it. The allowance for loan losses is established through a provision for loan losses charged to operations. The provision for loan losses is based on management’s periodic evaluation of individual loans, economic factors, past loan loss experience, changes in the composition and volume of the portfolio, and other relevant factors. The estimates used in determining the adequacy of the allowance for loan losses, including the amounts and timing of future cash flows expected on impaired loans, are particularly susceptible to changes in the near term.

Impaired loans are loans for which it is probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreements. The Company individually evaluates such loans for impairment and does not aggregate loans by major risk classifications. The definition of “impaired loans” is not the same as the definition of “nonaccrual loans,” although the two categories overlap. The Company may choose to place a loan on nonaccrual status due to payment delinquency or uncertain collectability, while not classifying the loan as impaired if the loan is not a commercial business or commercial real estate loan. Factors considered by management in determining impairment include payment status and collateral value. The amount of impairment for impaired loans is determined by the difference between the present value of the expected cash flows related to the loans, using the original interest rate, and their recorded value, or as a practical expedient in the case of collateralized loans, the difference between the fair value of the collateral and the recorded amount of the loans. When foreclosure is probable, impairment is measured based on the fair value of the collateral.

Mortgage loans and consumer loans are comprised of large groups of smaller balance homogeneous loans are evaluated for impairment collectively. Loans that experience insignificant payment delays, which are defined as less than 90 days, generally are not classified as impaired. Management determines the significance of payment delays 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 borrower’s prior payment record, and the amount of shortfall in relation to the principal and interest owed.

Unamortized Premiums and Discounts—Unamortized premiums and discounts on loans receivable, mortgage-backed securities and investment securities are amortized over the estimated average lives of the loans or securities purchased using a method which approximates the interest method.

Real Estate Owned—Real estate acquired through, or in lieu of, loan foreclosure is initially recorded at the lower of book value or the estimated fair value at the date of acquisition, less estimated selling costs, establishing a new cost basis. Costs related to the development and improvement of real estate owned properties are capitalized and those relating to holding the properties are charged to expense. After foreclosure, a valuation is periodically performed by management and a write-down is recorded, if necessary, by a charge to operations if the carrying value of a property exceeds its estimated fair value minus estimated costs to sell.

Federal Home Loan Bank of Pittsburgh (“FHLB”) Stock – FHLB stock is classified as a restricted equity security because ownership is restricted and there is not an established market for its resale. FHLB stock is carried at cost and is evaluated for impairment when certain conditions warrant further consideration.

The Company is a member of the Federal Home Loan Bank of Pittsburgh and as such, is required to maintain a minimum investment in stock of the Federal Home Loan Bank that varies with the level of advances outstanding with the Federal Home Loan Bank. The stock is bought from and sold to the Federal Home Loan Bank based upon its \$100 par value. The stock does not have a readily determinable fair value and as such is classified as restricted stock, carried at cost and evaluated for by management. The stock’s value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the Federal Home Loan Bank as compared to the capital stock amount and the length of time this situation has persisted; (b) commitments by the Federal Home Loan Bank to make payments required by law or regulation and the level of such payments in relation to the operating performance; (c) the impact of legislative and regulatory changes on the customer base of the Federal Home Loan Bank; and (d) the liquidity position of the Federal Home Loan Bank.

While the Federal Home Loan Banks have been negatively impacted by the current economic conditions, the Federal Home Loan Bank of Pittsburgh reported profits for 2010, remains in compliance with regulatory capital and liquidity requirements, continues to pay dividends on the stock and make redemptions at the par value. With consideration given to these factors, management concluded that the stock was not impaired at September 30, 2011 or 2010.

Office Properties and Equipment—Land is carried at cost. Office properties and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the expected useful lives of the assets. The costs of maintenance and repairs are expensed as they are incurred, and renewals and betterments are capitalized and depreciated over their useful lives.

Cash Surrender Value of Life Insurance—The Company funds the policy premiums on the lives of certain directors of the Bank. The Bank owned life insurance policies (“BOLI”) provide an attractive tax-exempt return to the Company and is being used by the Company to fund various employee benefit plans. The BOLI is recorded at its cash surrender value.

Dividend Payable – Upon declaration of a dividend, a payable is established with a corresponding reduction to retained earnings at the declaration date. There was no dividend payable as of September 30, 2011.

Employee Stock Ownership Plan – The Bank established an employee stock ownership plan (“ESOP”) for substantially all of its full-time employees. The ESOP purchased 452,295 shares of the Company’s common stock on the open market for approximately \$4.5 million with a loan from the Company. Shares of the Company’s common stock purchased by the ESOP are held in a suspense account until released for allocation to participants as the loan is repaid. Shares released will be allocated to each eligible participant based on the ratio of each such participant’s compensation, as defined in the ESOP, to the total compensation of all eligible plan participants in the ESOP. As the unearned shares are released from suspense, the Company recognizes compensation expense equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the ESOP shares released differs from the cost of such shares, the difference is recorded to equity as additional paid-in capital. As of September 30, 2011, the Company had allocated a total of 130,065 shares from the suspense account to participants and committed to release an additional 16,965 shares. The Company recognized compensation expense related to the ESOP of \$128,000 and \$167,000 for the years ended September 30, 2011 and 2010, respectively.

Share-Based Compensation – The Company accounts for stock-based compensation issued to employees, and where appropriate non-employees, in accordance with U.S. generally accepted accounting principles. Under fair value provisions, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the appropriate vesting period using the straight-line method. The amount of stock-based compensation recognized at any date must at least equal the portion of the grant date fair value of the award that is vested at that date and as a result it may be necessary to recognize the expense using a ratable method. Determining the fair value of stock-based awards at the date of grant requires judgment, including estimating the expected term of the stock options and the expected volatility of the Company’s stock. In addition, judgment is required in estimating the amount of stock-based awards that are expected to be forfeited. If actual results differ significantly from these estimates or different key assumptions were used, it could have a material effect on the Company’s Consolidated Financial Statements. See Note 11 of the Notes to Consolidated Financial Statements for additional information regarding stock-based compensation.

Treasury Stock – Common stock held in treasury by the Company is accounted for using the cost method, which treats stock held in treasury as a reduction to total stockholders’ equity. The average cost per share of the approximately 2.5 million shares which have been repurchased by the Company was \$12.45 for purchases through September 30, 2011. The repurchased shares held by the Company are available for general corporate purposes. As of September 30, 2011, the MHC had purchased 568,000 shares at an average cost of \$10.30 per share. As of September 30, 2011, 7,478,062 shares were owned by the MHC and 2,540,255 shares had been repurchased by the Company and held as treasury stock which results in 2,545,433 shares being owned by public shareholders.

Comprehensive Income—The Company presents in the consolidated statement of changes in stockholders’ equity and comprehensive income those amounts arising from transactions and other events which currently are excluded from the statements of operations and are recorded directly to stockholders’ equity. For the years ended September 30, 2011 and 2010, the only components of comprehensive income were net income, unrealized holding gains, net of income tax expense on available for sale securities and reclassifications related to realized losses due to other than temporary impairment, net of tax. Reclassifications are made to avoid double counting in comprehensive income items which are displayed as part of net income for the period.

Income Taxes— The Company records deferred income taxes that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management exercises significant judgment in the evaluation of the amount and timing of the recognition of the resulting tax assets and liabilities. The judgments and estimates required for the evaluation are updated based upon changes in business factors and the tax laws. If actual results differ from the assumptions and other considerations used in estimating the amount and timing of tax recognized, there can be no assurance that additional expense will not be required in future periods.

In evaluating the Company's ability to recover deferred tax assets, management considers all available positive and negative evidence, including past operating results and forecast of future taxable income. In determining future taxable income, management makes assumptions for the amount of taxable income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require us to make judgments about future taxable income and are consistent with the plans and estimates the Company uses to manage the business. Any reduction in estimated future taxable income may require us to record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the period and could have a significant impact on our future earnings.

Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—The Company recognizes the financial and servicing assets it controls and the liabilities it has incurred, and will derecognize financial assets when control has been surrendered, and derecognize liabilities when extinguished. Servicing assets and other retained interests in the transferred assets are measured by allocating the previous carrying amount between the asset sold, if any, and retained interests, if any, based on their relative fair values at the date of transfer.

Advertising Costs—Advertising costs are expensed as incurred. The Company recognized advertising expense of \$425,000 and \$432,000 for the years ended September 30, 2011 and 2010, respectively.

Recent Accounting Pronouncements

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll-forward of activity in Level three fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The adoption of this guidance is not expected to have a significant impact on the Company's financial statements.

In March 2010, the FASB issued ASU 2010-11, Derivatives and Hedging. ASU 2010-11 provides clarification and related additional examples to improve financial reporting by resolving potential ambiguity about the breadth of the embedded credit derivative scope exception in ASC 815-15-15-8. ASU 2010-11 is effective at the beginning of the first fiscal quarter beginning after June 15, 2010. The adoption of this guidance did not have an impact on the Company's financial statements.

In July 2010, the FASB issued ASU No. 2010-20, Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. ASU 2010-20 is intended to provide additional information to assist financial statement users in assessing an entity's credit risk exposures and evaluating the adequacy of its allowance for credit losses. The disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The amendments in ASU 2010-20 encourage, but do not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In August, 2010, the FASB issued ASU 2010-21, Accounting for Technical Amendments to Various SEC Rules and Schedules. This ASU amends various SEC paragraphs pursuant to the issuance of Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules, and Codification of Financial Reporting Policies and is not expected to have a significant impact on the Company's financial statements.

In August, 2010, the FASB issued ASU 2010-22, Technical Corrections to SEC Paragraphs – An announcement made by the staff of the U.S. Securities and Exchange Commission. This ASU amends various SEC paragraphs based on external comments received and the issuance of SAB 112, which amends or rescinds portions of certain SAB topics and is not expected to have a significant impact on the Company's financial statements.

In April 2011, the FASB issued ASU 2011-02, Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring. The amendments in this Update provide additional guidance or clarification to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The amendments in this Update are effective for the first interim or annual reporting period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning annual period of adoption. As a result of applying these amendments, an entity may identify receivables that are newly considered impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The adoption of this guidance did not have a material impact on the Company's financial position or results of operation.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. For nonpublic entities, the amendments are effective for annual periods beginning after December 15, 2011. Early application by public entities is not permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In June 2011, the FASB issued ASU 2011-05, Presentation of Comprehensive Income. The amendments in this Update improve the comparability, clarity, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS, the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity was eliminated. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. All entities that report items of comprehensive income, in any period presented, will be affected by the changes in this Update. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The amendments in this Update should be applied retrospectively, and early adoption is permitted. This ASU is not expected to have a significant impact on the Company's financial statements.

In September 2011, the FASB issued ASU 2011-08, Intangibles – Goodwill and Other Topics (Topic 350), Testing Goodwill for Impairment. The objective of this update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this Update apply to all entities, both public and nonpublic, that have goodwill reported in their financial statements and are effective for interim and annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. This ASU is not expected to have a significant impact on the Company's financial statements.

3.

EARNINGS PER SHARE

Basic earnings per common share is computed based on the weighted average number of shares outstanding. Diluted earnings per share is computed based on the weighted average number of shares outstanding and common share equivalents (“CSEs”) that would arise from the exercise of dilutive securities.

The calculated basic and diluted earnings per share are as follows:

	2011	Year Ended September 30,		
		2010		
	(Dollars in Thousands Except Per Share Data)			
	Basic	Diluted	Basic	Diluted
Net income	\$ 112	\$ 112	\$ 3,130	\$ 3,130
Weighted average shares outstanding	9,542,298	9,542,298	9,613,353	9,613,353
Effect of CSEs	-	86,892	-	118,958
Adjusted weighted average shares used in earnings per share computation	9,542,298	9,629,190	9,613,353	9,732,311
Income per share - basic and diluted	\$ 0.01	\$ 0.01	\$ 0.33	\$ 0.32

Options to purchase 442,400 shares of common stock at an exercise price greater than the current market value were outstanding at September 30, 2011 and 2010, but were not included in the computation of diluted earnings per share because to do so would have been antidilutive.

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4. INVESTMENT AND MORTGAGE-BACKED SECURITIES

The amortized cost and fair value of securities, with gross unrealized gains and losses, are as follows:

	Amortized Cost	September 30, 2011 Gross Unrealized		Fair Value
		Gains	Losses	
		(Dollars in Thousands)		
Securities Held to Maturity:				
U.S. government and agency obligations	\$ 87,708	\$ 1,457	\$ (81)	\$ 89,084
Mortgage-backed securities - U.S. government agencies	21,248	2,389	-	23,637
Total securities held to maturity	\$ 108,956	\$ 3,846	\$ (81)	\$ 112,721
Securities Available for Sale:				
U.S. government and agency obligations	\$ 9,360	\$ 100	\$ (36)	\$ 9,424
Mortgage-backed securities - U.S. government agencies	57,340	4,243	-	61,583
Mortgage-backed securities - non-agency Total debt securities	5,249 71,949	29 4,372	(921) (957)	4,357 75,364
FHLMC preferred stock	6	-	-	6
Total securities available for sale	\$ 71,955	\$ 4,372	\$ (957)	\$ 75,370

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	September 30, 2010			
	Amortized Cost	Gross Unrealized Gains (Dollars in Thousands)	Gross Unrealized Losses	Fair Value
Securities Held to Maturity:				
U.S. government and agency obligations	\$ 85,983	\$ 1,831	\$ (12)	\$ 87,802
Municipal obligations	475	-	-	475
Mortgage-backed securities - U.S. government agencies	26,215	2,102	-	28,317
Total securities held to maturity	\$ 112,673	\$ 3,933	\$ (12)	\$ 116,594
Securities Available for Sale:				
U.S. government and agency obligations	\$ 9,995	\$ 198	\$ -	\$ 10,193
Mortgage-backed securities - U.S. government agencies	51,821	3,204	-	55,025
Mortgage-backed securities - non-agency	8,067	178	(1,046)	7,199
Total debt securities	69,883	3,580	(1,046)	72,417
FHLMC preferred stock	8	-	-	8
Total securities available for sale	\$ 69,891	\$ 3,580	\$ (1,046)	\$ 72,425

The following table shows the gross unrealized losses and related fair values of the Company's investment securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position at September 30, 2011:

	Less than 12 months		More than 12 months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
(Dollars in Thousands)						
Securities Held to Maturity:						
U.S. government and agency obligations	\$ (81)	\$ 18,911	\$ -	\$ -	\$ (81)	\$ 18,911
Total securities held to maturity	\$ (81)	\$ 18,911	\$ -	\$ -	\$ (81)	\$ 18,911
Securities Available for Sale:						
U.S. government and agency obligations	\$ (36)	\$ 4,961	\$ -	\$ -	\$ (36)	\$ 4,961
Mortgage-backed securities - non-agency	(50)	1,108	(871)	2,663	(921)	3,771
	\$ (86)	\$ 6,069	\$ (871)	\$ 2,663	\$ (957)	\$ 8,732

Total securities
available for sale

Total	\$ (167)	\$ 24,980	\$ (871)	\$ 2,663	\$ (1,038)	\$ 27,643
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The equity securities and U.S. government agency mortgage-backed securities were not in an unrealized loss position as of September 30, 2011.

Management has reviewed its investment securities and determined that for the year ended September 30, 2011 unrealized losses of \$204,000 on a pre-tax basis for certain securities in the non-agency mortgage-backed portfolio classified as available for sale were deemed other than temporary.

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when economic or market conditions warrant such evaluation. The evaluation is based upon factors such as the creditworthiness of the issuers/guarantors, the underlying collateral, if applicable, and the continuing performance of the securities. Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost, and near-term prospects of the issuer.

The Company assesses whether the credit loss existed by considering whether (1) the Company has the intent to sell the security, (2) it is more likely than not that it will be required to sell the security before recovery, or (3) it does not expect to recover the entire amortized cost basis of the security. The Company bifurcates the OTTI impact on impaired securities where impairment in value was deemed to be other than temporary between the component representing credit loss and the component representing loss related to other factors. The portion of the fair value decline attributable to credit loss must be recognized through a charge to earnings. The credit component is determined by comparing the present value of the cash flows expected to be collected, discounted at the rate in effect before recognizing any OTTI with the amortized cost basis of the debt security. The Company uses the cash flow expected to be realized from the security, which includes assumptions about interest rates, timing and severity of defaults, estimates of potential recoveries, the cash flow distribution from the bond indenture and other factors, then applies a discount rate equal to the effective yield of the security. The difference between the present value of the expected cash flows and the amortized book value is considered a credit loss. The fair market value of the security is determined using the same expected cash flows; the discount rate is a rate the Company determines from the open market and other sources as appropriate for the security. The difference between the fair market value and the security’s remaining amortized cost is recognized in other comprehensive income.

The following is a rollforward for the year ended September 30, 2011 of the amounts recognized in earnings related to credit losses on securities which the Company has recorded other than temporary impairment charges through earnings and other comprehensive income.

	(Dollars in Thousands)
Credit component of OTTI as of October 1, 2010	\$ 3,087
Additions for credit-related OTTI charges on previously unimpaired securities	7
Reductions for securities liquidated	(887)
Additional increases as a result of impairment charges recognized on investments for which an OTTI was previously recognized	197
Credit component of OTTI as of September 30, 2011	\$ 2,404

U.S. government and agency obligations - The Company's investments in the preceding table in U.S. Government sponsored enterprise notes consist of debt obligations of the FHLB and Federal Farm Credit System ("FFCS"). These securities are typically rated AAA by one of the internationally recognized credit rating services. At September 30, 2011, securities in a gross unrealized loss for less than twelve months consisted of 9 securities having an aggregate depreciation of \$117,000 or 0.1% from the Company's amortized cost basis. There were no securities in a gross unrealized loss for more than twelve months. The unrealized losses on these debt securities relates principally to the changes in market interest rates and a lack of liquidity currently in the financial markets and are not as a result of projected shortfall of cash flows. In addition, the Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell the securities. As such, the Company anticipates it will recover the entire amortized cost basis of the securities. As a result, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2011.

Mortgage-Backed Securities non-agency - This portfolio was acquired through the redemption-in-kind during 2008 of an investment in a mutual fund and includes 59 collateralized mortgage obligations ("CMO") and MBS securities issued by large commercial financial institutions. For the year ended September 30, 2011 management recognized an OTTI charge related to a portion of the portfolio securities in the amount of \$277,000 on a pre-tax basis due to the fact that, in management's judgment, the credit quality of the collateral pool underlying such securities had deteriorated during recent periods to the point that full recovery of the entire amortized cost of the investment was considered to be uncertain. This portfolio consists primarily of securities with underlying collateral of Alt-A loans and those collateralized by home equity lines of credit and other receivables as well as whole loans with more significant exposure to depressed real estate markets in the United States. For the overall portfolio of the securities, there was exposure to the declining real estate markets such as California, Nevada, Arizona and Florida and consequently, an additional OTTI charge was deemed to be warranted as of September 30, 2011. Of the recorded charge, a total of \$204,000 was concluded to be credit related and recognized currently in earnings and \$73,000 was concluded to be attributable to other factors and recognized in other accumulated comprehensive income.

As of September 30, 2011, with the exception of securities discussed above, there are no securities for which the Company currently believes it is not probable that it will collect all amounts due according to the contractual terms of the investment. Management concluded that an other-than-temporary impairment did not exist and the decline in value was attributed to the illiquidity in the financial markets. With respect to the \$921,000 in gross unrealized losses related to this portfolio, 24 securities had been in a loss position for longer than 12 months while 16 securities had been in a loss position for less than 12 months. However, the Company does not intend to sell these securities and it is

more likely than not that the Company will not be required to sell these securities.

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The following table shows the gross unrealized losses and related fair values of the Company's investment securities, aggregated by investment category and length of time that individual securities have been in a continuous loss position at September 30, 2010:

	Less than 12 months		More than 12 months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
(Dollars in Thousands)						
Securities Held to Maturity:						
U.S. government and agency obligations	\$ (12)	\$ 5,988	\$ -	\$ -	\$ (12)	\$ 5,988
Total securities held to maturity	\$ (12)	\$ 5,988	\$ -	\$ -	\$ (12)	\$ 5,988
Securities Available for Sale:						
Mortgage-backed securities - non-agency	\$ (9)	\$ 225	\$ (1,037)	\$ 3,311	\$ (1,046)	\$ 3,536
Total securities available for sale	(9)	225	(1,037)	3,311	(1,046)	3,536
Total	\$ (21)	\$ 6,213	\$ (1,037)	\$ 3,311	\$ (1,058)	\$ 9,524

The equity securities, municipal obligations and U.S. government agency MBS were not in an unrealized loss position as of September 30, 2010.

Management has reviewed its investment securities and determined that for the year ended September 30, 2010 unrealized losses of \$560,000 on a pre-tax basis for certain securities in the non-agency MBS portfolio classified as available for sale were deemed other than temporary. With respect to the \$1.0 million in gross unrealized losses related to this portfolio at September 30, 2010, 29 securities had been in a loss position for longer than 12 months while six securities had been in a loss position for less than 12 months. However, the Company did not intend to sell these securities and it was more likely than not that the Company would not be required to sell these securities.

The amortized cost and estimated fair value of U.S. agency and municipal obligations, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because of call provisions in the securities. MBS were not included as the contractual maturity is generally irrelevant due to the borrowers' right to prepay without pre-payment penalty.

	September 30, 2011			
	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in Thousands)			
Due after one through five years	\$ 11,000	\$ 11,110	\$ -	\$ -
Due after five through ten years	49,960	50,658	2,999	3,098
Due after ten years	26,748	27,316	6,361	6,326
Total	\$ 87,708	\$ 89,084	\$ 9,360	\$ 9,424

	September 30, 2010			
	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in Thousands)			
Due after one through five years	\$ 9,475	\$ 9,491	\$ -	\$ -
Due after five through ten years	24,991	25,936	5,996	6,156
Due after ten years	51,992	52,850	3,999	4,037
Total	\$ 86,458	\$ 88,277	\$ 9,995	\$ 10,193

For the years ended September 30, 2011 and 2010, the Company realized gross gains of \$15,000 and \$-0-, respectively, and proceeds from the sale of non-agency mortgage-backed securities of \$105,000 and \$-0-, respectively.

5. LOANS RECEIVABLE

Loans receivable consist of the following:

	September 30,	
	2011	2010
	(Dollars in Thousands)	
One-to four-family residential	\$ 196,533	\$ 197,164
Multi-family residential	5,723	4,006
Commercial real estate	21,175	19,710
Construction and land development	22,226	40,650
Commercial business	814	893
Consumer	613	595
 Total loans	 247,084	 263,018
 Undisbursed portion of loans-in-process	 (3,773)	 (5,366)
Deferred loan costs	564	590
Allowance for loan losses	(3,364)	(3,151)
 Net	 \$ 240,511	 \$ 255,091

The Company originates loans to customers located primarily in its local market area. The ultimate repayment of these loans at September 30, 2011 and 2010 is dependent, to a certain degree, on the local economy and real estate market.

The Company originates both adjustable and fixed interest rate loans. At September 30, 2011 and 2010, the Bank had \$36.8 million and \$47.7 million of adjustable-rate loans, respectively. The adjustable-rate loans have interest rate adjustment limitations and are generally indexed to the one-year U.S. Treasury note rate, Wall Street Journal prime rate or the Average Contract Interest Rate for previously occupied houses as reported by the Federal Housing Finance Board.

The following table summarizes the loans individually evaluated for impairment by loan segment at September 30, 2011:

	One- to four- family residential	Multi-family residential	Commercial real estate	Construction and land development	Commercial business	Consumer	Total
	(Dollars in Thousands)						
Total loans	\$ 196,533	\$ 5,723	\$ 21,175	\$ 22,226	\$ 814	\$ 613	\$ 247,084
Individually evaluated for impairment	\$ 7,652	\$ -	\$ 545	\$ 3,235	\$ -	\$ -	\$ 11,432
Collectively evaluated for impairment	188,881	5,723	20,630	18,991	814	613	235,652

The loan portfolio is segmented at a level that allows management to monitor risk and performance. Management evaluates all construction and land development loans and 90 plus days delinquent commercial real estate, multi-family residential and commercial business loans for potential impairment. Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement.

Once the determination is made that a loan is impaired, the determination of whether a specific allocation of the allowance for loan losses is necessary is generally measured by comparing the recorded investment in the loan to the fair value of the loan using one of the following three methods: (a) the present value of the expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. Management primarily utilizes the fair value of collateral method as a practically expedient alternative when the proceeds to repay the loan are expected to come solely from the liquidation of collateral.

The following table presents impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary as of September 30, 2011:

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
	Recorded Investment	Related Allowance	Recorded Investment	Recorded Investment	Unpaid Principal Balance
One-to-four family residential	\$ 7,652	\$ 495	\$ -	\$ 7,652	\$ 8,402
Multi-family residential	-	-	-	-	-
Commercial real estate	-	-	545	545	545
Construction and land development	-	-	3,235	3,235	6,846
Commercial business	-	-	-	-	-
Consumer	-	-	-	-	-
Total Loans	\$ 7,652	\$ 495	\$ 3,780	\$ 11,432	\$ 15,793

The following table presents the average investment in impaired loans and related interest income recognized for the periods indicated:

	Year ended September 30,	
	2011	2010
	(Dollars in Thousands)	
Impaired loans with a valuation allowance	\$ 7,652	\$ 5,059
Impaired loans without a valuation allowance	\$ 3,780	\$ -
Average recorded investment in impaired loans	\$ 9,306	\$ 2,191
Interest income recognized on an accrual basis on impaired loans	\$ 189	\$ 165
Interest income recognized on a cash basis on impaired loans	\$ 267	\$ -

Federal regulations and our policies require that the Company utilize an internal asset classification system as a means of reporting problem and potential problem assets. The Company has incorporated an internal asset classification system, consistent with Federal banking regulations, as a part of the credit monitoring system. Management currently classifies problem and potential problem assets as “substandard,” “doubtful” or “loss” assets. An asset is considered “substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” that the insured institution will sustain “some loss” if the deficiencies are not corrected. Assets classified as “doubtful” have all of the weaknesses inherent in those classified “substandard” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” Assets classified as “loss” are those considered “uncollectible” and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets which do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are required to be designated “special mention.”

The following table presents the classes of the loan portfolio in which a formal risk weighting system is utilized summarized by the aggregate “Pass” and the criticized categories of “special mention”, “substandard” and “doubtful” within the Company’s risk rating system as of September 30, 2011. The Company has no loans classified as “loss” at such date.

	Pass	Special Mention	Substandard	Doubtful	Total Loans
	(Dollars in Thousands)				
Multi-family residential	\$ 5,723	\$ -	\$ -	\$ -	\$ 5,723
Commercial real estate	20,630	-	545	-	21,175
Construction and land development	11,917	3,901	6,408	-	22,226
Commercial business	814	-	-	-	814
Total Loans	\$ 39,084	\$ 3,901	\$ 6,953	\$ -	\$ 49,938

The following table represents loans in which a formal risk rating system is not utilized, but loans are segregated between performing and non-performing based on delinquency status:

	Performing (Dollars in Thousands)	Non- Performing	Total Loans
One-to-four family residential	\$ 186,219	\$ 10,314	\$ 196,533
Consumer	613	-	613
Total Loans	\$ 186,832	\$ 10,314	\$ 197,146

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is due. The following table presents the classes of the loan portfolio summarized by the aging categories of performing loans and nonaccrual loans as of September 30, 2011:

	Current (Dollars in Thousands)	30-89 Days Past Due	90 Days + Past Due	90 Days+ Past Due and Accruing	Total Past Due and Accruing	Total Loans	Non- Accrual
One-to-four family residential	\$ 190,822	\$ 3,048	\$ 2,663	\$ -	\$ 3,048	\$ 196,533	\$ 10,314
Multi-family residential	5,723	-	-	-	-	5,723	-
Commercial real estate	20,272	358	545	-	358	21,175	545
Construction and land development	20,454	-	1,772	-	-	22,226	1,772
Commercial business	814	-	-	-	-	814	-
Consumer	613	-	-	-	-	613	-
Total Loans	\$ 238,698	\$ 3,406	\$ 4,980	\$ -	\$ 3,406	\$ 247,084	\$ 12,631

The allowance for loan losses is established through a provision for loan losses charged to expense. The Company maintains the allowance at a level believed, to the best of management's knowledge, to cover all known and inherent losses in the portfolio that are both probable and reasonable to estimate at each reporting date. Management reviews the allowance for loan losses on no less than a quarterly basis in order to identify those inherent losses and to assess the overall collection probability for the loan portfolio. For each primary type of loan, management establishes a loss factor reflecting the estimate of the known and inherent losses in such loan type using both a quantitative analysis as well as consideration of qualitative factors. Management's evaluation process includes, among other things, an analysis of delinquency trends, non-performing loan trends, the level of charge-offs and recoveries, prior loss experience, total loans outstanding, the volume of loan originations, the type, size and geographic concentration of the loans, the value of collateral securing the loan, the borrower's ability to repay and repayment performance, the number of loans requiring heightened management oversight, local economic conditions and industry experience.

Management considers commercial real estate loans, multi-family residential loans, commercial business loans, and land acquisition, development and construction loans to be riskier than one- to four-family residential mortgage loans. Commercial and multi-family residential real estate loans entail significant additional credit risks compared to one- to four-family residential mortgage loans, as they frequently involve large loan balances concentrated with single borrowers or groups of related borrowers. In addition, the payment experience on loans secured by income-producing properties typically depends on the successful operation of the related real estate project and/or business operation of the borrower who is also the primary occupant, and thus may be subject to a greater extent to adverse conditions in the real estate market and in the general economy. Commercial business loans involve a higher risk of default than residential loans of like duration since their repayment is generally dependent on the successful operation of the borrower's business and the sufficiency of collateral, if any. Land acquisition, development and construction lending exposes us to greater credit risk than permanent mortgage financing. The repayment of land acquisition, development and construction loans depends upon the sale of the property to third parties or the availability of permanent financing upon completion of all improvements. In the event the Company makes an acquisition loan on property that is not yet approved for the planned development, there is the risk that approvals will not be granted or will be delayed. These events may adversely affect the borrower and the collateral value of the property. Development and construction loans also expose us to the risk that improvements will not be completed on time in accordance with specifications and projected costs. In addition, the ultimate sale or rental of the property may not occur as anticipated. All of these factors are considered as part of the underwriting, structuring and pricing of the loan.

The following schedule summarizes the changes in the allowance for loan losses:

	Year Ended September 30,	
	2011	2010
	(Dollars in Thousands)	
Balance, beginning of year	\$ 3,151	\$ 2,732
Provision for loan losses	4,630	1,110
Charge-offs	(4,417)	(691)
Recoveries	-	-
Balance, end of year	\$ 3,364	\$ 3,151

The following table summarizes the primary segments of the allowance for loan losses, segmented into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment as of September 30, 2011. Activity in the allowance is presented for the year ended September 30, 2011:

	One- to four-family residential (In Thousands)	Multi- family residential	Commercial real estate	Construction and land development	Commercial business	Consumer	Unallocated	Total
ALLL balance at September 30, 2010	\$ 672	\$ 4	\$ 560	\$ 1,909	\$ 3	\$ 1	\$ 2	\$ 3,151
Charge-offs	(750)	-	-	(3,667)	-	-	-	(4,417)
Recoveries	-	-	-	-	-	-	-	-
Provision	1,729	3	(339)	3,239	-	-	(2)	4,630
ALLL balance at September 30, 2011	\$ 1,651	\$ 7	\$ 221	\$ 1,481	\$ 3	\$ 1	\$ -	\$ 3,364
Individually evaluated for impairment	\$ 495	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 495
Collectively evaluated for impairment	1,156	7	221	1,481	3	1	-	2,869

For the year ended September 30, 2011, the Company established a \$4.6 million provision for loan losses as compared to \$1.1 million for fiscal 2010. The increased level of provisions in the year ended September 30, 2011 reflected primarily the provisions established in connection with the recognition of declines in the value of collateral securing two construction development projects. The first project involves a \$4.3 million construction loan secured by a 33-unit condominium project in Philadelphia. During the second quarter of fiscal 2011, due to the lack of recent sales in the project combined with deterioration in real estate values in the market, in particular for condominiums, the Company made a determination to utilize the “bulk sale” appraised value of the remaining units in the project rather than the retail value. This re-evaluation resulted in a charge-off of \$2.6 million during the second quarter of fiscal 2011 of which \$1.9 million was recognized as provision expense. An additional charge-off of \$241,000 was recognized on this project during the fourth quarter of fiscal 2011 as a subsequent appraisal indicated a further decline in value of the collateral. The second project involves an aggregate of \$1.8 million in loans secured by the seven unsold units associated with a 17-unit townhouse project in Philadelphia. Based on both the decline in the value of the collateral securing the project and the lack of sales, the Company determined to charge off \$1.5 million of which \$1.1 million was recognized as provision expense during the second quarter of fiscal 2011. These increases in the provision were partially offset by a credit to provision expense related to commercial real estate loans as the amount of 90 day + delinquent loans decreased substantially during the year.

Management will continue to monitor and modify the allowance for loan losses as conditions dictate. No assurances can be given that the level of allowance for loan losses will cover all of the inherent losses on the loans or that future adjustments to the allowance for loan losses will not be necessary if economic and other conditions differ substantially from the economic and other conditions used by management to determine the current level of the allowance for loan losses.

The following table summarizes information in regards to troubled debt restructurings at September 30, 2011:

	Number of Contracts (Dollars in Thousands)	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments
One-to-four family residential	5	\$ 7,824	\$ 7,652
Multi-family residential	-	-	-
Commercial real estate	-	-	-
Construction and land development	-	-	-
Commercial business	-	-	-
Consumer	-	-	-

At September 30, 2011, the Company had five one-to-four family residential loans classified as troubled debt restructurings. These loans were all to the same borrower and are related to a 132-unit completed condominium project in Philadelphia. There was a \$113,000 decrease in interest income as a result of the restructuring. These loans have a specific allocation of \$495,000 and are on non-accrual. All of the troubled debt restructurings were changes in interest rates and no debt was forgiven. At September 30, 2011, there were no troubled debt restructurings in default subsequent to the restructuring.

6. OFFICE PROPERTIES AND EQUIPMENT

Office properties and equipment are summarized by major classifications as follows:

	September 30, 2011	2010
	(Dollars in Thousands)	
Land	\$ 247	\$ 247
Buildings and improvements	2,565	2,565
Furniture and equipment	3,519	3,430
Automobiles	144	144
Total	6,475	6,386
Accumulated depreciation	(4,659)	(4,317)
Total office properties and equipment, net of accumulated depreciation	\$ 1,816	\$ 2,069

For the years ended September 30, 2011 and 2010, depreciation expense amounted to \$342,000 and \$355,000, respectively.

7. DEPOSITS

Deposits consist of the following major classifications:

	2011		September 30,		2010	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)					
Money market deposit accounts	\$ 75,649	17.4 %	\$ 75,822	16.3 %		
Interest bearing checking accounts	29,658	6.8	26,072	5.6		
Non-interest bearing checking accounts	3,847	0.9	2,570	0.6		
Passbook, club and statement savings	70,623	16.2	69,901	15.1		
Certificates maturing in six months or less	52,539	12.0	111,180	23.9		
Certificates maturing in more than six months	203,698	46.7	178,910	38.5		
Total	\$ 436,014	100.0 %	\$ 464,455	100.0 %		

The amount of scheduled maturities of certificate accounts was as follows:

	September 30, 2011	
	(Dollars in Thousands)	
One year or less	\$	121,984
One through two years		84,895
Two through three years		20,968
Three through four years		14,267
Four through five years		14,123
Total	\$	256,237

Certificates of deposit of \$100,000 or more at September 30, 2011 and 2010 totaled approximately \$97.4 million and \$113.0 million, respectively.

Interest expense on deposits was comprised of the following:

	Year Ended September 30,	
	2011	2010
	(Dollars in Thousands)	
Checking and money market deposit accounts	\$ 779	\$ 1,119
Passbook, club and statement savings accounts	701	1,230
Certificate accounts	5,611	6,321
Total	\$ 7,091	\$ 8,670

8. ADVANCES FROM FEDERAL HOME LOAN BANK

Advances from the FHLB totaled \$570,000 and \$615,000 at September 30, 2011 and 2010, respectively. These advances were obtained in connection with the Bank's participation in a community housing program ranging in maturity from fiscal years 2012 through 2015.

The advances are collateralized by all of the Federal Home Loan Bank stock, U.S. government and agency investment securities and substantially all qualifying first mortgage loans held by the Bank. At September 30, 2011, the Bank had the ability to obtain \$123.1 million of additional FHLB advances.

9. INCOME TAXES

The Company files a consolidated federal income tax return. The Company uses the specific charge-off method for computing reserves for bad debts. Generally this method allows the Company to deduct an annual addition to the reserve for bad debt equal to its net charge-offs.

The provision for income taxes for the years ended September 30, 2011 and 2010 consists of the following:

	Year Ended September 30,	
	2011	2010
	(Dollars in Thousands)	
Current:		
Federal	\$ 1,536	\$ 1,528
State	-	-
Total current taxes	1,536	1,528
Deferred income tax benefit	(1,748)	(482)
Total income tax (benefit) provision	\$ (212)	\$ 1,046

Items that gave rise to significant portions of deferred income taxes are as follows:

	September 30,	
	2011	2010
	(Dollars in Thousands)	
Deferred tax assets:		
Deposit premium	\$ 69	\$ 118
Allowance for loan losses	2,695	1,114
Real estate owned expenses	101	291
Non-accrual interest	128	-
Accrued vacation	78	59
Capital loss carryforward	1,986	1,873
Impairment loss	1,510	1,553
Post-retirement benefit plans	176	173
Split dollar life insurance	31	33
Employee benefit plans	345	298
Total deferred tax assets	7,119	5,512
Valuation allowance	(2,009)	(2,209)
Total deferred tax assets, net of valuation allowance	5,110	3,303
Deferred tax liabilities:		
Unrealized gain on available for sale securities	1,161	861
Property	545	478
Mortgage servicing	1	2
Deferred loan fees	192	200
Total deferred tax liabilities	1,899	1,541
Net deferred tax asset	\$ 3,211	\$ 1,762

The Company establishes a valuation allowance for deferred tax assets when management believes that the deferred tax assets are not likely to be realized either through a carry back to taxable income in prior years, future reversals of existing taxable temporary differences, and, to a lesser extent, future taxable income. The tax deduction generated by the redemption of the shares of the mutual fund and the subsequent impairment charge on the assets acquired through the redemption in kind are considered a capital loss and can only be utilized to the extent of capital gains over a five year period, resulting in the establishment of a valuation allowance for the carryforward period which expires beginning in 2013. The valuation allowance totaled \$2.0 million and \$2.2 million at September 30, 2011 and 2010, respectively. Based on the September 30, 2011 valuation of the deferred tax asset, the gross deferred asset related to impairment losses increased by \$70,000 during fiscal 2011 while the corresponding valuation allowance decreased by \$200,000, resulting in an income tax benefit of \$270,000 corresponding to the increase in value of available for sale mortgage-backed securities which may be sold in the future to generate capital gains.

The income tax expense differs from that computed at the statutory federal corporate tax rate as follows:

	Year Ended September 30, 2011		2010	
	Amount (Dollars in Thousands)	Percentage of Pretax Income	Amount	Percentage of Pretax Income
Tax at statutory rate	\$ (34)	(34.0)%	\$ 1,420	34.0 %
Adjustments resulting from:				
Valuation allowance	(200)	(200.0)	(342)	(8.2)
Income from bank owned life insurance	(65)	(65.0)	(69)	(1.7)
Income from municipal obligations	-	-	(13)	(0.3)
Employee benefit plans	84	84.0	54	1.3
Other	3	3.0	(4)	(0.1)
Income tax (benefit) expense per statements of income	\$ (212)	(212.0)%	\$ 1,046	25.0 %

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the Consolidated Statement of Operations as a component of income tax expense. As of September 30, 2011, the Internal Revenue Service is in the process of conducting an audit of the Company's tax returns for the year ended September 30, 2010. The Company's federal and state income tax returns for taxable years through September 30, 2007 have been closed for purposes of examination by the Internal Revenue Service and the Pennsylvania Department of Revenue.

10. REGULATORY CAPITAL REQUIREMENTS

The Company and the Bank are 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 the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices.

The Company's and the Bank's capital amounts and the Bank's classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital (as defined in the regulations) to average assets (as defined) and risk-weighted assets (as defined), and of total capital (as defined) to risk-weighted assets. Management believes, as of September 30, 2011 and 2010, that the Company and the Bank met all regulatory capital adequacy requirements to which they are subject.

To be categorized as well capitalized, the Bank must maintain the minimum Tier 1 capital, Tier 1 risk-based and total risk-based ratios as set forth in the table below.

The Company's and the Bank's actual capital amounts and ratios are also presented in the following table:

	Actual		Required for Capital Adequacy Purposes			To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount (Dollars in Thousands)	Ratio	Amount	Ratio	Amount	Ratio	
September 30, 2011:							
Tier 1 capital (to average assets)							
Company	\$ 55,199	11.06 %	\$ 19,961	4.0 %	N/A	N/A	
Bank	51,051	10.23	19,961	4.0	\$ 24,951	5.0	%
Tier 1 capital (to risk-weighted assets)							
Company	55,199	25.54	8,645	4.0	N/A	N/A	
Bank	51,051	23.62	8,645	4.0	12,968	6.0	
Total capital (to risk-weighted assets)							
Company	57,909	26.79	17,290	8.0	N/A	N/A	
Bank	53,761	24.87	17,290	8.0	21,613	10.0	
September 30, 2010:							
Tier 1 capital (to average assets)							
Company	\$ 55,327	10.27 %	\$ 21,541	4.0 %	N/A	N/A	
Bank	50,932	9.46	21,541	4.0	\$ 26,926	5.0	%
Tier 1 capital (to risk-weighted assets)							
Company	55,327	23.12	9,573	4.0	N/A	N/A	
Bank	50,932	21.28	9,573	4.0	14,359	6.0	
Total capital (to risk-weighted assets)							
Company	58,320	24.37	19,146	8.0	N/A	N/A	
Bank	53,925	22.53	19,146	8.0	23,932	10.0	

11.

EMPLOYEE BENEFITS

The Bank is a member of a multi-employer defined benefit pension plan covering all employees meeting certain eligibility requirements. The Bank's policy is to fund pension costs accrued. Information regarding the actuarial present values of vested and nonvested benefits and fair value of plan assets for the separate employers in the plan is not available. The expense relating to this plan for the years ended September 30, 2011 and 2010 was \$730,000 and \$722,000, respectively.

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The Bank also has a defined contribution plan for employees meeting certain eligibility requirements. The defined contribution plan may be terminated at any time at the discretion of the Bank. There was no expense relating to this plan for the years ended September 30, 2011 and 2010. The elimination of the expense reflected the Company's decision to discontinue the employer match in conjunction with the establishment of the employee stock ownership plan ("ESOP") discussed below.

The Bank maintains an ESOP for substantially all of its full-time employees meeting certain eligibility requirements. The purchase of shares of the Company's common stock by the ESOP was funded by a loan from the Company. The loan will be repaid principally from the Bank's contributions to the ESOP. Shares of the Company's common stock purchased by the ESOP are held in a suspense account and released for allocation to participants on a pro rata basis as debt service payments are made on the loan. Shares released are allocated to each eligible participant based on the ratio of each such participant's base compensation, as defined in the ESOP, to the total base compensation of all eligible plan participants. As the unearned shares are released and allocated among participants, the Bank recognizes compensation expense based on the current market price of the shares released. The ESOP purchased 452,295 shares of the Company's common stock on the open market for a total cost of approximately \$4.5 million. The average purchase price was \$9.86 per share. As of September 30, 2011, the Company had allocated a total of 130,065 shares from the suspense account to participants and committed to release an additional 16,965 shares. As of September 30, 2010 the Company had allocated a total of 107,445 shares from the suspense account to participants and committed to release an additional 16,965 shares. The expense relating to the ESOP for the years ended September 30, 2011 and 2010 was \$128,000 and \$167,000, respectively.

The Company maintains a Recognition and Retention Plan and Trust Agreement ("RRP") which is administered by a committee of the Board of Directors of the Company. The RRP provides for the grant of shares of common stock of the Company to certain officers, employees and directors of the Company. In order to fund the grant of shares under the RRP, the RRP Trust purchased 226,148 shares of the Company's common stock in the open market for approximately \$2.5 million, at an average purchase price per share of \$10.85. The Company made sufficient contributions to the RRP Trust to fund these purchases. No additional purchases of shares are expected to be made by the RRP Trust under this plan. During January 2009, grants covering 173,228 shares were awarded as part of the RRP. An additional 5,654 shares were awarded during January 2010. The remaining 47,266 shares in the RRP Trust are available for future awards. Shares subject to awards under the RRP will generally vest at the rate of 20% per year over five years. As of September 30, 2011, 70,422 of the awarded shares had become fully vested and no shares subject to awards had been forfeited.

Compensation expense related to the shares subject to awards granted is recognized ratably over the five-year vesting period in an amount per share equal to the fair value at the grant date. During the year ended September 30, 2011, approximately \$390,000 was recognized in compensation expense for the RRP. Tax benefits of \$71,000 were recognized during the year ended September 30, 2011. During the year ended September 30, 2010, approximately \$387,000 was recognized in compensation expense for the RRP. Tax benefits of \$87,000 were recognized during the year ended September 30, 2010. At September 30, 2011, approximately \$892,000 additional compensation expense for the shares awarded related to the RRP remained unrecognized.

A summary of the Company's non-vested stock award activity for the year ended September 30, 2011 is presented in the following table:

		Year Ended September 30, 2011	
	Number of Shares	Weighted Average Grant Date Fair Value	
Nonvested stock awards at beginning of year	144,236	\$	11.11
Issued	-		-
Vested	(35,776)		11.12
Nonvested stock awards at the end of the period	108,460	\$	11.10

The Company maintains a Stock Option Plan which authorizes the grant of stock options to officers, employees and directors of the Company to acquire shares of common stock with an exercise price at least equal to the market value of the common stock on the grant date. Options will generally become vested and exercisable at the rate of 20% per year over five years and are generally exercisable for a period of ten years after the grant date. A total of 565,369 shares of common stock were approved for future issuance pursuant to the Stock Option Plan. As of September 30, 2011, 315,194 incentive stock options and 127,206 non-qualified stock options had been awarded under the plan. As of September 30, 2011, options covering 174,133 shares were vested and exercisable, while none had been forfeited.

A summary of the status of the Company's stock options under the Stock Option Plan as of September 30, 2011 and changes during the year ended September 30, 2011 are presented below:

		Year Ended September 30, 2011	
	Number of Shares	Weighted Average Exercise Price	
Options outstanding at beginning of year	442,400	\$	11.12
Granted	-		-
Exercised	-		-
Forfeited	-		-
Outstanding at the end of the period	442,400	\$	11.12
Exercisable at the end of the period	174,133	\$	11.14

The weighted average remaining contractual term was approximately 7.25 years for options outstanding as of September 30, 2011.

The estimated fair value of options granted during fiscal 2009 was \$2.81 per share, while options granted during fiscal 2010 were estimated to have a fair value of \$2.76. The fair value was estimated on the date of grant using the Black-Scholes pricing model with the following weighted average assumptions used:

	Granted Fiscal Year	
	2009	Ended 2010
Dividend yield	1.79 %	2.10 %
Expected volatility	27.94 %	28.95 %
Risk-free interest rate	1.96 %	3.10 %
Expected life of options	6.5 years	6.5 years

During the year ended September 30, 2011, \$244,000 was recognized in compensation expense for the Stock Option Plan. A tax benefit of \$24,000 was recognized during the year ended September 30, 2011. During the year ended September 30, 2010, \$242,000 was recognized in compensation expense for the Stock Option Plan. A tax benefit of \$23,000 was recognized during the year ended September 30, 2010. At September 30, 2011, approximately \$558,000 in additional compensation expense for awarded options remained unrecognized. The weighted average period over which this expense will be recognized is approximately 2.25 years.

12. COMMITMENTS AND CONTINGENT LIABILITIES

At September 30, 2011, the Company had \$7.2 million in outstanding commitments to originate fixed and variable-rate loans with market interest rates ranging from 4.125% to 7.25%. At September 30, 2010, the Company had \$6.1 million in outstanding commitments to originate fixed and variable-rate loans with market interest rates ranging from 4.875% to 6.75%.

The aggregate undisbursed portion of loans-in-process amounted to \$3.8 million and \$5.4 million, respectively, at September 30, 2011 and 2010.

The Company also had commitments under unused lines of credit of \$7.8 million and \$6.9 million, respectively, and letters of credit outstanding of \$676,000 at both September 30, 2011 and 2010.

The Company is subject to various pending claims and contingent liabilities arising in the normal course of business which are not reflected in the accompanying consolidated financial statements. Management considers that the aggregate liability, if any, resulting from such matters will not be material.

Among the Company's contingent liabilities are exposures to limited recourse arrangements with respect to the Company's sales of whole loans and participation interests. At September 30, 2011, the exposure, which represents a portion of credit risk associated with the sold interests, amounted to \$64,000. This exposure is for the life of the related loans and payables, on the Company's proportionate share, as actual losses are incurred.

The Company leases certain property and equipment under non-cancelable operating leases. Scheduled minimum payments are as follows for the fiscal years ended:

September 30,	Lease Obligation (Dollars in Thousands)
2012	\$ 78
2013	78
2014	78
2015	52
Total	\$ 286

Rent expense for all operating leases was approximately \$78,000 and \$77,000 for fiscal years ending September 30, 2011 and 2010, respectively.

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the fair value amounts.

	2011	September 30, 2010		
	Carrying Amount	Fair Value (Dollars in Thousands)	Carrying Amount	Fair Value
Assets:				
Cash and cash equivalents	\$ 53,829	\$ 53,829	\$ 66,524	\$ 66,524
Investment and mortgage-backed securities held to maturity	108,956	112,721	112,673	116,594
Investment and mortgage-backed securities available for sale	75,370	75,370	72,425	72,425
Loans receivable, net	240,511	248,382	255,091	262,777
Accrued interest receivable	2,026	2,026	3,197	3,197
Federal Home Loan Bank stock	2,887	2,887	3,545	3,545
Bank owned life insurance	6,180	6,180	5,990	5,990
Liabilities:				
Checking accounts	33,505	33,505	28,642	28,642
Money market deposit accounts	75,649	75,649	75,822	75,822
Passbook, club and statement savings accounts	70,623	70,623	69,901	69,901
Certificates of deposit	256,237	262,489	290,090	296,087
Advances from Federal Home Loan Bank	570	570	615	614
Accrued interest payable	2,420	2,420	3,361	3,361

Cash and Cash Equivalents—For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value.

Investments and Mortgage-Backed Securities—The fair value of investment securities and mortgage-backed securities is based on quoted market prices, dealer quotes, and prices obtained from independent pricing services that may be derivable from observable and unobservable market inputs.

Loans Receivable—The fair value of loans is estimated based on present value using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Accrued interest receivable —For accrued interest receivable, the carrying amount is a reasonable estimate of fair value.

Federal Home Loan Bank (FHLB) Stock—Although FHLB stock is an equity interest in an FHLB, it is carried at cost because it does not have a readily determinable fair value as its ownership is restricted and it lacks a market. The estimated fair value approximates the carrying amount.

Bank Owned Life insurance—The fair value of bank owned life insurance is based on the cash surrender values obtained from an independent advisor that may be derivable from observable and unobservable market inputs.

Checking Accounts, Money Market Deposit Accounts, Passbook Accounts, Club Accounts, Statement Savings Accounts, and Certificates of Deposit—The fair value of passbook accounts, club accounts, statement savings accounts, checking accounts, and money market deposit accounts is the amount reported in the financial statements. The fair value of certificates of deposit is based on a present value estimate using rates currently offered for deposits of similar remaining maturity.

Advances from Federal Home Loan Bank—The fair value of advances from FHLB is based on the contractual cash flows discounted using rates currently offered for new notes with similar remaining maturities.

Accrued interest payable —For accrued interest payable, the carrying amount is a reasonable estimate of fair value.

Commitments to Extend Credit and Letters of Credit—The majority of the Company's commitments to extend credit and letters of credit carry current market interest rates if converted to loans. Because commitments to extend credit and letters of credit are generally unassignable by either the Company or the borrower, they only have value to the Company and the borrower. The fair value approximates the recorded deferred fee amounts, which are not significant.

14. FAIR VALUE MEASUREMENTS

The fair value estimates presented herein are based on pertinent information available to management as of September 30, 2011 and September 30, 2010, respectively. Although management is not aware of any factors that would significantly affect the fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

The Company follows a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

The three broad levels of hierarchy are as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Fair values for securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique that is widely used in the financial services industry to value debt securities without relying exclusively on quoted prices for specific securities but rather by relying on the securities' relationship to other benchmark-quoted securities.

Those assets which will continue to be measured at fair value on a recurring basis as of September 30, 2011 are as follows:

	Category Used for Fair Value Measurement			
	Level 1	Level 2	Level 3	Total
	(Dollars in Thousands)			
Assets:				
Securities available for sale:				
U.S. Government and agency obligations	\$-	\$9,424	\$-	\$9,424
Mortgage-backed securities - U.S. Government agencies	-	61,583	-	61,583
Mortgage-backed securities - non-agency	-	4,357	-	4,357
FNMA and FHLMC preferred stock	6	-	-	6
Total	\$6	\$75,364	\$-	\$75,370

Those assets which will continue to be measured at fair value on a recurring basis as of September 30, 2010 are as follows:

	Category Used for Fair Value Measurement			Total
	Level 1	Level 2	Level 3	
	(Dollars in Thousands)			
Assets:				
Securities available for sale:				
U.S. Government and agency obligations	\$ -	\$ 10,193	\$ -	\$ 10,193
Mortgage-backed securities - U.S.				
Government agencies	-	55,025	-	55,025
Mortgage-backed securities - non-agency	-	7,199	-	7,199
FNMA and FHLMC preferred stock	8	-	-	8
Total	\$ 8	\$ 72,417	\$ -	\$ 72,425

Certain assets are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The Company measures impaired loans and loans or bank properties transferred into real estate owned at fair value on a non-recurring basis.

Impaired Loans

The Company considers loans to be impaired when it becomes more likely than not that the Company will be unable to collect all amounts due in accordance with the contractual terms of the loan agreement. Collateral dependent impaired loans are based on the fair value of the collateral which is based on appraisals and would be categorized as Level 2 measurement. In some cases, adjustments are made to the appraised values for various factors including age of the appraisal, age of the comparables included in the appraisal, and known changes in the market and in the collateral. These adjustments are based upon unobservable inputs, and therefore, the fair value measurement has been categorized as a Level 3 measurement. Specific reserves were calculated for impaired loans with carrying amounts totaling \$11.4 million at September 30, 2011. The collateral underlying these loans had a fair value of \$10.9 million resulting in specific reserves in the allowance for loan losses of \$495,000.

Transfer of Impaired Loans into Real Estate Owned

Once an asset is determined to be uncollectible, the underlying collateral is repossessed and reclassified to foreclosed real estate and repossessed assets. These assets are carried at lower of cost or fair value of the collateral, less cost to sell and would be categorized as Level 2 measurement. Thus the evaluations are based upon observable inputs, and therefore, the fair value measurement has been categorized as a Level 2 measurement.

Summary of Non-Recurring Fair Value Measurements

At September 30, 2011
(In Thousands)

	Level 1	Level 2	Level 3	Total
Impaired loans	\$ -	\$ -	\$ 10,937	10,937
Real estate owned	-	2,268	-	2,268
Total	\$ -	\$ 2,268	\$ 10,937	\$ 13,205

At September 30, 2010
(In Thousands)

	Level 1	Level 2	Level 3	Total
Impaired loans	\$ -	\$ 4,249	\$ -	4,249
Real estate owned	-	3,197	-	3,197
Total	\$ -	\$ 7,446	\$ -	\$ 7,446

15. PRUDENTIAL BANCORP, INC. OF PENNSYLVANIA (PARENT COMPANY ONLY)

STATEMENT OF FINANCIAL CONDITION

At September 30,

	2011	2010
	(Dollars in Thousands)	
Assets:		
Cash	\$ 500	\$ 1,062
ESOP loan receivable	3,521	3,689
Investment in Bank	53,304	52,604
Other assets	127	146
Total assets	\$ 57,452	\$ 57,501
Liabilities:		
Accrued dividend payable	\$ -	\$ 502
Total liabilities	-	502
Stockholders' equity:		
Preferred stock	-	-
Common stock	126	126
Additional paid-in-capital	54,078	53,528
Unearned ESOP shares	(3,011)	(3,234)
Treasury stock	(31,625)	(31,576)
Retained earnings	35,631	36,483
Accumulated other comprehensive income	2,253	1,672
Total stockholders' equity	57,452	56,999
Total liabilities and stockholders' equity	\$ 57,452	\$ 57,501

INCOME STATEMENT

For the year ended September 30,

	2011	2010
	(Dollars in thousands)	
Interest on ESOP loan	\$209	\$218
Equity in the undistributed loss of the Bank	(642)	(1,576)
Dividends from Bank	1,000	5,000
Other income	16	15
 Total income	 583	 3,657
Professional services	236	288
Other expense	362	390
 Total expense	 598	 678
 Income (loss) before income taxes/benefit	 (15)	 2,979
 Income tax benefit	 (127)	 (151)
 Net income	 \$112	 \$3,130

CASH FLOWS

For the year ended September 30,

	2011	2010
	(Dollars in thousands)	
Operating activities:		
Net income	\$ 112	\$ 3,130
Decrease in assets	31	107
Equity in the undistributed loss of the Bank	642	1,576
 Net cash provided by operating activities	 785	 4,813
Investing activities:		
Repayments received on ESOP loan	168	159
 Net cash provided by investing activities	 168	 159
Financing activities:		
Cash dividends paid	(1,466)	(1,940)
Payment to repurchase common stock	(49)	(2,924)
 Net cash used in financing activities	 (1,515)	 (4,864)
 Net (decrease) increase in cash and cash equivalents	 (562)	 108
 Cash and cash equivalents, beginning of year	 1,062	 954
 Cash and cash equivalents, end of year	 \$ 500	 \$ 1,062

16. CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)

Unaudited quarterly financial data for the years ended September 30, 2011 and 2010 is as follows:

	September 30, 2011				September 30, 2010			
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
	(In thousands)				(In thousands)			
Interest income	\$ 5,653	\$ 5,446	\$ 5,454	\$ 5,132	\$ 6,466	\$ 6,311	\$ 6,312	\$ 6,020
Interest expense	2,022	1,816	1,683	1,576	2,489	2,286	2,344	2,298
Net interest income	3,631	3,630	3,771	3,556	3,977	4,025	3,968	3,722
Provision for loan losses	580	3,600	-	450	135	250	110	615
Net income after provision for loan losses	3,051	30	3,771	3,106	3,842	3,775	3,858	3,107
Non-interest income	134	175	241	329	19	62	169	137
Non-interest expense	2,863	2,807	2,614	2,653	2,553	2,661	2,789	2,791
Income (loss) before income expense/benefit	322	(2,602)	1,398	782	1,308	1,176	1,238	453
Income tax expense (benefit)	416	(740)	227	(115)	622	333	(41)	131
Net (loss) income	\$ (94)	\$ (1,862)	\$ 1,171	\$ 897	\$ 686	\$ 843	\$ 1,279	\$ 322
Per share:								
Income (loss) per share - basic	\$ (0.01)	\$ (0.20)	\$ 0.12	\$ 0.09	\$ 0.07	\$ 0.09	\$ 0.13	\$ 0.03
Income (loss) per share - diluted	(0.01)	(0.20)	0.12	0.09	0.07	0.09	0.13	0.03
Dividends per share	0.05	0.05	-	-	0.05	0.05	0.05	0.05

Due to rounding, the sum of the income (loss) per share in individual quarters may differ from reported amounts.

17. SUBSEQUENT EVENTS

During December 2011, the Company entered into an agreement of sale with respect to a real estate owned property owned by the Bank. The property, which consists of a single-family residence, has a book value of \$309,000. A loss of approximately \$120,000 is anticipated to be recognized during the quarter ending December 31, 2011. The sale is expected to settle during January 2012.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

Not Applicable.

Item 9A. Controls and Procedures

(a) Management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of September 30, 2011. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and regulations and are operating in an effective manner.

(b) Report of Management's Assessment of Internal Control over Financial Reporting

Management is responsible for designing, implementing, documenting, and maintaining an adequate system of internal control over financial reporting. An adequate system of internal control over financial reporting encompasses the processes and procedures that have been established by management to:

- maintain records that accurately reflect the Company's transactions;
- prepare financial statement and footnote disclosures in accordance with U.S. GAAP that can be relied upon by external users;
- prevent and detect unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the criteria in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation under the criteria in Internal Control-Integrated Framework, management concluded that internal control over financial reporting was effective as of September 30, 2011. Furthermore, during the conduct of its assessment, management identified no material weakness in its financial reporting control system.

The Board of Directors of Prudential Bancorp, through its Audit Committee, provides oversight to managements' conduct of the financial reporting process. The Audit Committee, which is composed entirely of independent directors, is also responsible to recommend the appointment of independent public accountants. The Audit Committee also meets with management, the internal audit staff, and the independent public accountants throughout the year to provide assurance as to the adequacy of the financial reporting process and to monitor the overall scope of the work performed by the internal audit staff and the independent public accountants.

Because of its inherent limitations, the disclosure controls and procedures may not prevent or detect misstatements. A control system, no matter how well conceived and operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm under rules of the Securities and Exchange Commission that permits the Company to provide only management's report in this annual report.

/s/ Thomas A. Vento
Thomas A. Vento
President and Chief Executive Officer

/s/ Joseph R. Corrato
Joseph R. Corrato
Executive Vice President,
Chief Financial Officer and
Chief Accounting Officer

(c) No change in the internal control over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f) under the Securities Exchange Act of 1934) occurred during the fourth fiscal quarter of fiscal 2011 that has materially affected, or is reasonably likely to materially affect, the internal control over financial reporting.

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required herein is incorporated by reference from the sections captioned "Information with Respect to Nominees for Director, Continuing Directors and Executive Officers" and "Beneficial Ownership of Common Stock by Certain Beneficial Owners and Management – Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's Definitive Proxy Statement for the Annual Meeting of Shareholders to be held on February 6, 2012, which will be filed with the Securities and Exchange Commission on or about January 6, 2012 ("Definitive Proxy Statement").

The Company has adopted a code of ethics policy, which applies to its principal executive officer, principal financial officer, principal accounting officer, as well as its directors and employees generally. The Company will provide a copy of its code of ethics to any person, free of charge, upon request. Any requests for a copy should be made to the shareholder relations administrator, Prudential Bancorp, Inc. of Pennsylvania, 1834 Oregon Avenue, Philadelphia, Pennsylvania 19145.

Item 11. Executive Compensation

The information required herein is incorporated by reference from the sections captioned "Management Compensation" and "Compensation Committee Interlocks and Insider Participation" in the Company's Definitive Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Security Ownership of Certain Beneficial Owners and Management. Information regarding security ownership of certain beneficial owners and management is incorporated by reference to “Beneficial Ownership of Common Stock by Certain Beneficial Owners and Management” in the Definitive Proxy Statement.

Equity Compensation Plan Information. The following table provides information as of September 30, 2011 with respect to shares of common stock that may be issued under the existing equity compensation plans, which consist of the 2008 Stock Option Plan and 2008 Recognition and Retention Plan, both of which were approved by the Company’s shareholders.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	442,400	(1) \$ 11.12	(1) 170,235
Equity compensation plans not approved by security holders	--	--	--
Total	442,400	\$ 11.12	170,235

(1) Includes 108,460 shares subject to restricted stock grants which were not vested as of September 30, 2011. The weighted-average exercise price excludes such restricted stock grants.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required herein is incorporated by reference from the sections captioned “Beneficial Ownership of Common Stock by Certain Beneficial Ownership Management – Related Party Transactions” and “Information with Respect to Nominees for Director, Continuing Directors and Executive Officers” in the Definitive Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information required herein is incorporated by reference from the section captioned “Ratification of Appointment of Independent Registered Public Accounting Firm (Proposal Two) – Audit Fees” in the Definitive Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) Documents Filed as Part of this Report.

(1) The following financial statements are incorporated by reference from Item 8 hereof:

Consolidated Statements of Financial Condition
Consolidated Statements of Operations
Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income (Loss)
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

(2) All schedules for which provision is made in the applicable accounting regulation of the SEC are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.

(3) The following exhibits are filed as part of this Form 10-K, and this list includes the Exhibit Index.

Exhibit No.	Description
3.1	Articles of Incorporation of Prudential Bancorp, Inc. of Pennsylvania(1)
3.2	Bylaws of Prudential Bancorp, Inc. of Pennsylvania(1)
4.0	Form of Stock Certificate of Prudential Bancorp, Inc. of Pennsylvania(1)
10.1	Amended and Restated Employment Agreement between Prudential Savings Bank and Thomas A. Vento(2)*
10.2	Amended and Restated Employment Agreement between Prudential Savings Bank and Joseph R. Corrato(2)*
10.3	Amended and Restated Post Retirement Agreement between Prudential Savings Bank and Joseph W. Packer, Jr. (2)*
10.4	Amended and Restated Split-Dollar Collateral Assignment with Joseph W. Packer, Jr. and Diane B. Packer(2)*
10.5	Amended and Restated Split-Dollar Collateral Assignment with Joseph W. Packer, Jr. (2)*
10.6	Amendment No. 1 to Split-Dollar Agreement between the Bank and Joseph W. Packer, Jr. (2)*
10.7	Settlement Agreement, dated November 7, 2008, by and among Prudential Mutual Holding Company, Prudential Bancorp, Inc. of Pennsylvania, Prudential Savings Bank, Stilwell Value Partners, I, L.P., Stilwell Partners L.P., Stilwell Value LLC, Joseph Stilwell and John Stilwell (3)
10.8	Prudential Bancorp, Inc. of Pennsylvania 2008 Stock Option Plan (4)*
10.9	Prudential Bancorp, Inc. of Pennsylvania 2008 Recognition and Retention Plan and Trust Agreement (5)*
10.10	Amendment No.2 to Split-Dollar Agreement between the Bank and Joseph W. Packer, Jr.*
21.0	Subsidiaries of the Registrant – Reference is made to “Item 1. Business – Subsidiaries” for the required information
23.1	Consent of SR Snodgrass, A.C.
31.1	Section 1350 Certification of the Chief Executive Officer
31.2	Section 1350 Certification of the Chief Financial Officer
32.0	Section 906 Certification

*Management contract or compensatory plan or arrangement required to be filed as an exhibit to this Annual Report on Form 10-K pursuant to Item 15(b) hereof.

(1) Incorporated by reference from the Company’s Registration Statement on Form S-1 (Commission File No. 333-119130) filed with the Commission on September 30, 2004.

(2) Incorporated by reference from the Company’s Current Report on Form 8-K, dated November 19, 2008 and filed with the Commission on November 25, 2008 (Commission File No. 000-51214).

(3) Incorporated by reference from the Company’s Current Report on Form 8-K, dated November 7, 2008 and filed with the Commission on November 7, 2008 (Commission File No. 000-51214).

(4) Incorporated by reference from Appendix A of Prudential Bancorp, Inc. of Pennsylvania’s definitive proxy statement (Commission File No. 000-51214) filed with the Commission on November 26, 2008.

The following Exhibits are being furnished* as part of this report:

No.	Description
101.INS	XBRL Instance Document.*
101.SCH	XBRL Taxonomy Extension Schema Document.*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document.*

*These interactive data files are being furnished as part of this Annual Report, and, in accordance with Rule 402 of Regulation S-T, shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

(b) Exhibits

The exhibits listed under (a)(3) of this Item 15 are filed herewith.

(c) Reference is made to (a)(2) of this Item 15.

