ACNB CORP
Form 10-Q
August 01, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

Commission file number 0-11783

ACNB CORPORATION

(Exact name of Registrant as specified in its charter)

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

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

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

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

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

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

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

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

The number of shares of the Registrant s Common Stock outstanding on August 1, 2014, was 6,005,346.

PART I - FINANCIAL INFORMATION

ACNB CORPORATION

ITEM 1 - FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

Dollars in thousands, except per share data	June 30, 2014	June 30, 2013	December 31, 2013
ASSETS			
Cash and due from banks	**$ 15,423**	$ 15,398	$ 13,963
Interest bearing deposits with banks	**13,703**	22,820	4,153
Total Cash and Cash Equivalents	**29,126**	38,218	18,116
Securities available for sale	**122,938**	141,536	129,983
Securities held to maturity, fair value $76,916; $88,351; $92,082	**77,593**	90,314	94,373
Loans held for sale	**2,013**	2,427	496
Loans, net of allowance for loan losses $15,763; $17,239; $16,091	**733,534**	683,357	712,557
Premises and equipment	**16,320**	15,147	15,991
Restricted investment in bank stocks	**5,439**	4,603	6,861
Investment in bank-owned life insurance	**37,386**	31,757	32,237
Investments in low-income housing partnerships	**4,143**	5,180	4,687
Goodwill	**6,308**	6,308	6,308
Intangible assets	**1,521**	2,089	1,845
Foreclosed assets held for resale	**1,486**	2,485	1,762
Other assets	**19,446**	15,435	20,831
Total Assets	**$ 1,057,253**	$ 1,038,856	$ 1,046,047
LIABILITIES AND STOCKHOLDERS EQUITY			
LIABILITIES			
Deposits:			
Non-interest bearing	**$ 142,245**	$ 132,776	$ 128,011
Interest bearing	**679,031**	693,609	672,632
Total Deposits	**821,276**	826,385	800,643
Short-term borrowings	**42,202**	51,250	49,052
Long-term borrowings	**76,572**	52,830	82,703
Other liabilities	**6,749**	6,595	6,847
Total Liabilities	**946,799**	937,060	939,245
STOCKHOLDERS EQUITY			
Preferred stock, $2.50 par value; 20,000,000 shares authorized; no shares outstanding			
Common stock, $2.50 par value; 20,000,000 shares authorized; 6,067,946, 6,043,616 and 6,053,911 shares issued; 6,005,346, 5,981,016 and 5,991,311 shares outstanding	**15,170**	15,109	15,135

Treasury stock, at cost (62,600 shares)		**(728)**		(728)		(728)
Additional paid-in capital		**9,860**		9,475		9,628
Retained earnings		**85,586**		80,360		82,661
Accumulated other comprehensive income (loss)		**566**		(2,420)		106
Total Stockholders Equity		**110,454**		101,796		106,802
Total Liabilities and Stockholders Equity	**$**	**1,057,253**	$	1,038,856	$	1,046,047

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Dollars in thousands, except per share data	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
INTEREST INCOME				
Loans, including fees	**$ 8,033**	$ 7,980	**$ 16,023**	$ 16,234
Securities:				
Taxable	**951**	1,048	**1,962**	2,088
Tax-exempt	**267**	294	**540**	642
Dividends	**60**	6	**89**	10
Other	**14**	28	**30**	48
Total Interest Income	**9,325**	9,356	**18,644**	19,022
INTEREST EXPENSE				
Deposits	**441**	560	**866**	1,221
Short-term borrowings	**14**	15	**34**	27
Long-term borrowings	**450**	443	**907**	902
Total Interest Expense	**905**	1,018	**1,807**	2,150
Net Interest Income	**8,420**	8,338	**16,837**	16,872
PROVISION FOR LOAN LOSSES		500	**150**	1,150
Net Interest Income after Provision for Loan Losses	**8,420**	7,838	**16,687**	15,722
OTHER INCOME				
Service charges on deposit accounts	**533**	548	**998**	1,086
Income from fiduciary activities	**411**	312	**737**	643
Earnings on investment in bank-owned life insurance	**289**	254	**544**	495
Net gains on sales or calls of securities	**52**		**52**	
Service charges on ATM and debit card transactions	**400**	356	**759**	675
Commissions from insurance sales	**1,532**	1,399	**2,597**	2,530
Other	**175**	271	**307**	656
Total Other Income	**3,392**	3,140	**5,994**	6,085
OTHER EXPENSES				
Salaries and employee benefits	**4,954**	4,864	**9,709**	9,612
Net occupancy	**490**	493	**1,074**	1,008
Equipment	**677**	792	**1,320**	1,450
Other tax	**182**	232	**371**	470
Professional services	**270**	191	**574**	435
Supplies and postage	**120**	185	**273**	316
Marketing and corporate relations	**204**	113	**301**	212
FDIC and regulatory	**201**	192	**399**	401
Intangible assets amortization	**163**	161	**325**	321
Foreclosed real estate expenses (income)	**74**	(72)	**117**	(93)
Other operating	**885**	866	**1,439**	1,641
Total Other Expenses	**8,220**	8,017	**15,902**	15,773

Income before Income Taxes		**3,592**		2,961		**6,779**		6,034
PROVISION FOR INCOME TAXES		**861**		639		**1,576**		1,294
Net Income	**$**	**2,731**	$	2,322	**$**	**5,203**	$	4,740
PER SHARE DATA								
Basic earnings	**$**	**0.46**	$	0.38	**$**	**0.87**	$	0.79
Cash dividends declared	**$**	**0.19**	$	0.19	**$**	**0.38**	$	0.38

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

Dollars in thousands	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
NET INCOME	**$ 2,731**	$ 2,322	**$ 5,203**	$ 4,740
OTHER COMPREHENSIVE INCOME (LOSS)				
SECURITIES				
Unrealized gains (losses) arising during the period, net of income taxes of $178, $(1,023), $243 and $(1,254), respectively	**349**	(1,987)	**474**	(2,436)
Reclassification adjustment for net gains included in net income, net of income taxes of $(18), $0, $(18) and $0, respectively (A) (C)	**(34)**		**(34)**	
PENSION				
Amortization of pension net loss, transition liability, and prior service cost, net of income taxes of $11, $59, $11 and $118, respectively (B) (C)	**20**	114	**20**	228
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	**335**	(1,873)	**460**	(2,208)
TOTAL COMPREHENSIVE INCOME	**$ 3,066**	$ 449	**$ 5,663**	$ 2,532

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

(A) Gross amounts are included in net gains on sales or calls of securities on the Consolidated Statement of Income in total other income.

(B) Gross amounts are included in the computation of net periodic benefit cost and are included in salaries and employee benefits on the Consolidated Statements of Income in total other expenses.

(C) Income tax amounts are included in the provision for income taxes on the Consolidated Statements of Income.

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

Six Months Ended June 30, 2014 and 2013

Dollars in thousands	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders Equity
BALANCE JANUARY 1, 2013	$ 15,070	$ (728)	$ 9,246	$ 77,888	$ (212)	$ 101,264
Net income				4,740		4,740
Other comprehensive loss, net of taxes					(2,208)	(2,208)
Common stock shares issued (15,648 shares)	39		229			268
Cash dividends declared				(2,268)		(2,268)
BALANCE JUNE 30, 2013	$ 15,109	$ (728)	$ 9,475	$ 80,360	$ (2,420)	$ 101,796
BALANCE JANUARY 1, 2014	**$ 15,135**	**$ (728)**	**$ 9,628**	**$ 82,661**	**$ 106**	**$ 106,802**
Net income				**5,203**		**5,203**
Other comprehensive income, net of taxes					**460**	**460**
Common stock shares issued (14,035 shares)	**35**		**232**			**267**
Cash dividends declared				**(2,278)**		**(2,278)**
BALANCE JUNE 30, 2014	**$ 15,170**	**$ (728)**	**$ 9,860**	**$ 85,586**	**$ 566**	**$ 110,454**

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Dollars in thousands	Six Months Ended June 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 5,203**	$ 4,740
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of loans originated for sale	**(47)**	(353)
Gain on sales of foreclosed assets held for resale, including writedowns	**(23)**	(185)
Earnings on investment in bank-owned life insurance	**(544)**	(495)
Gain on sales or calls of securities	**(52)**	
Depreciation and amortization	**1,001**	1,002
Provision for loan losses	**150**	1,150
Net amortization of investment securities premiums	**425**	483
Decrease in accrued interest receivable	**104**	160
Increase (decrease) in accrued interest payable	**2**	(378)
Mortgage loans originated for sale	**(3,825)**	(16,699)
Proceeds from sales of loans originated for sale	**2,355**	21,312
Decrease in other assets	**1,370**	490
(Decrease) increase in other liabilities	**(69)**	21
Net Cash Provided by Operating Activities	**6,050**	11,248
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of investment securities held to maturity	**16,529**	5,319
Proceeds from maturities of investment securities available for sale	**10,277**	27,177
Proceeds from sales of investment securities available for sale	**1,228**	
Purchase of investment securities held to maturity		(45,695)
Purchase of investment securities available for sale	**(3,917)**	(6,875)
Net (increase) decrease in loans	**(21,651)**	6,366
Redemption of restricted investment in bank stocks	**1,422**	715
Purchase of bank-owned life insurance	**(4,605)**	(140)
Capital expenditures	**(1,006)**	(699)
Proceeds from sale of low-income housing partnerships	**219**	
Proceeds from sale of foreclosed real estate	**823**	2,385
Net Cash Used in Investing Activities	**(681)**	(11,447)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits	**14,234**	13,479
Net increase (decrease) in time certificates of deposits and interest bearing deposits	**6,399**	(21,270)
Net (decrease) increase in short-term borrowings	**(6,850)**	3,947
Dividends paid	**(2,278)**	(2,268)
Common stock issued	**267**	268
Proceeds from long-term borrowings	**10,000**	
Repayments on long-term borrowings	**(16,131)**	(7,124)
Net Cash Provided by (Used in) Financing Activities	**5,641**	(12,968)
Net Increase (Decrease) in Cash and Cash Equivalents	**11,010**	(13,167)
CASH AND CASH EQUIVALENTS BEGINNING	**18,116**	51,385

CASH AND CASH EQUIVALENTS ENDING	**$**	**29,126**	$	38,218
Interest paid	**$**	**1,805**	$	2,528
Income taxes paid	**$**	**500**	$	2,225
Loans transferred to foreclosed assets held for resale	**$**	**524**	$	438

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

ACNB CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. **Basis of Presentation**

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

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

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

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

The accounting policies followed by the Corporation are set forth in Note A to the Corporation s consolidated financial statements in the 2013 ACNB Corporation Annual Report on Form 10-K, filed with the SEC on March 7, 2014. It is suggested that the consolidated financial statements contained herein be read in conjunction with the consolidated financial statements and notes included in the Corporation s Annual Report on Form 10-K. The results of operations for the three and six month periods ended June 30, 2014, are not necessarily indicative of the results to be expected for the full year.

The Corporation has evaluated events and transactions occurring subsequent to the statement of condition date of June 30, 2014, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

2. **Earnings Per Share**

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 5,995,165 and 5,969,089 weighted average shares of common stock outstanding for the six months ended June 30, 2014 and 2013, respectively, and 5,997,999 and 5,971,929 for the three months ended June 30, 2014 and 2013, respectively. The Corporation does not have dilutive securities outstanding.

3. **Retirement Benefits**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
In thousands	**2014**	**2013**	**2014**	**2013**
Service cost	**$ 172**	$ 194	**$ 344**	$ 388
Interest cost	**259**	223	**518**	446
Expected return on plan assets	**(578)**	(489)	**(1,156)**	(978)
Amortization of net loss	**5**	163	**11**	326
Amortization of prior service cost	**10**	10	**20**	20
Net Periodic Benefit (Income) Cost	**$ (132)**	$ 101	**$ (263)**	$ 202

The Corporation previously disclosed in its consolidated financial statements for the year ended December 31, 2013, that it had not yet determined the amount the Bank planned on contributing to the defined benefit plan in 2014. As of June 30, 2014, this contribution amount had still not been determined. Effective April 1, 2012, no inactive or former participant in the plan is eligible to again participate in the plan, and no employee hired after March 31, 2012, is eligible to participate in the plan. As of the last annual census, ACNB Bank had a combined 368 active, vested, terminated and retired persons in the plan.

4. **Guarantees**

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $4,009,000 in standby letters of credit as of June 30, 2014. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability, as of June 30, 2014, for guarantees under standby letters of credit issued is not material.

5. **Accumulated Other Comprehensive Income (Loss)**

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

In thousands	**Unrealized Gains on Securities**	**Pension Liability**	**Accumulated Other Comprehensive Income (Loss)**
BALANCE JUNE 30, 2014	**$ 3,012**	**$ (2,446)**	**$ 566**

BALANCE	DECEMBER 31, 2013	$	2,572	$	(2,466)	$	106
BALANCE	JUNE 30, 2013	$	3,178	$	(5,598)	$	(2,420)

6. **Segment Reporting**

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

Segment information for the six month periods ended June 30, 2014 and 2013, is as follows:

In thousands	Banking	Insurance	Total
2014			
Net interest income and other income from external customers	**$ 20,229**	**$ 2,602**	**$ 22,831**
Income before income taxes	**6,297**	**482**	**6,779**
Total assets	**1,048,410**	**8,843**	**1,057,253**
Capital expenditures	**1,006**		**1,006**
2013			
Net interest income and other income from external customers	$ 20,443	$ 2,514	$ 22,957
Income before income taxes	5,657	377	6,034
Total assets	1,029,276	9,580	1,038,856
Capital expenditures	692	7	699

Segment information for the three month periods ended June 30, 2014 and 2013, is as follows:

In thousands	Banking	Insurance	Total
2014			
Net interest income and other income from external customers	**$ 10,280**	**$ 1,532**	**$ 11,812**
Income before income taxes	**3,173**	**419**	**3,592**
Total assets	**1,048,410**	**8,843**	**1,057,253**
Capital expenditures	**563**		**563**
2013			
Net interest income and other income from external customers	$ 10,084	$ 1,394	$ 11,478
Income before income taxes	2,682	279	2,961
Total assets	1,029,276	9,580	1,038,856
Capital expenditures	466		466

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

7. **Securities**

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

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether

management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Amortized cost and fair value of securities at June 30, 2014, and December 31, 2013, were as follows:

In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
JUNE 30, 2014				
U.S. Government and agencies	**$ 19,035**	**$ 504**	**$**	**$ 19,539**
Mortgage-backed securities, residential	**49,089**	**2,500**	**3**	**51,586**
State and municipal	**38,583**	**1,327**	**39**	**39,871**
Corporate bonds	**10,002**	**137**	**4**	**10,135**
CRA mutual fund	**1,044**	**7**		**1,051**
Stock in other banks	**627**	**129**		**756**
	$ 118,380	**$ 4,604**	**$ 46**	**$ 122,938**
DECEMBER 31, 2013				
U.S. Government and agencies	$ 21,094	$ 557	$	$ 21,651
Mortgage-backed securities, residential	51,541	2,322	123	53,740
State and municipal	40,780	1,117	375	41,522
Corporate bonds	11,004	192	31	11,165
CRA mutual fund	1,044		11	1,033
Stock in other banks	627	245		872
	$ 126,090	$ 4,433	$ 540	$ 129,983
SECURITIES HELD TO MATURITY				
JUNE 30, 2014				
U.S. Government and agencies	**$ 24,508**	**$**	**$ 403**	**$ 24,105**
Mortgage-backed securities, residential	**53,085**	**252**	**526**	**52,811**
	$ 77,593	**$ 252**	**$ 929**	**$ 76,916**
DECEMBER 31, 2013				
U.S. Government and agencies	$ 37,528	$ 142	$ 923	$ 36,747
Mortgage-backed securities, residential	56,845	40	1,550	55,335
	$ 94,373	$ 182	$ 2,473	$ 92,082

The following table shows the Corporation s investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2014, and December 31, 2013:

	Less than 12 Months		12 Months or More		Total	
In thousands	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
SECURITIES AVAILABLE FOR SALE						
JUNE 30, 2014						
Mortgage-backed securities, residential	**$ 171**	**$ 2**	**$ 644**	**$ 1**	**$ 815**	**$ 3**
State and municipal	**149**	**1**	**4,625**	**38**	**4,774**	**39**
Corporate bond	**4,996**	**4**			**4,996**	**4**
	$ 5,316	**$ 7**	**$ 5,269**	**$ 39**	**$ 10,585**	**$ 46**
DECEMBER 31, 2013						
Mortgage-backed securities, residential	$ 6,944	$ 123	$	$	$ 6,944	$ 123
State and municipal	11,107	340	1,070	35	12,177	375
Corporate bond	4,969	31			4,969	31
CRA mutual fund	1,033	11			1,033	11
	$ 24,053	$ 505	$ 1,070	$ 35	$ 25,123	$ 540
SECURITIES HELD TO MATURITY						
JUNE 30, 2014						
U.S. Government and agencies	**$ 1,933**	**$ 67**	**$ 22,172**	**$ 336**	**$ 24,105**	**$ 403**
Mortgage-backed securities, residential			**25,278**	**526**	**25,278**	**526**
	$ 1,933	**$ 67**	**$ 47,450**	**$ 862**	**$ 49,383**	**$ 929**
DECEMBER 31, 2013						
U.S. Government and agencies	$ 22,710	$ 812	$ 2,889	$ 111	$ 25,599	$ 923
Mortgage-backed security, residential	45,891	1,446	1,755	104	47,646	1,550
	$ 68,601	$ 2,258	$ 4,644	$ 215	$ 73,245	$ 2,473

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

At June 30, 2014, two available for sale residential mortgage-backed securities had unrealized losses that individually did not exceed 2% of amortized cost. One of these securities has been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At June 30, 2014, eleven available for sale state and municipal bonds had unrealized losses that individually did not exceed 3% of amortized cost. Ten of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At June 30, 2014, one available for sale corporate bond had an unrealized loss that did not exceed 1% of amortized cost. This security has not been in a continuous loss position for 12 months or more. This unrealized loss relates principally to changes in interest rates subsequent to the

acquisition of the specific security.

At June 30, 2014, sixteen held to maturity U.S. Government and agency securities had unrealized losses that individually did not exceed 5% of amortized cost. Fifteen of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

At June 30, 2014, eighteen held to maturity residential mortgage-backed securities had unrealized losses that individually did not exceed 3% of amortized cost. All of these securities have been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of the specific securities.

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

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

Management routinely sells securities from its available for sale portfolio in an effort to manage and allocate the portfolio. At June 30, 2014, management had not identified any securities with an unrealized loss that it intends to sell or will be required to sell. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses.

Amortized cost and fair value at June 30, 2014, by contractual maturity, where applicable, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	Available for Sale		Held to Maturity	
In thousands	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
1 year or less	**$ 7,856**	**$ 8,007**	**$**	**$**
Over 1 year through 5 years	**29,685**	**30,822**	**16,053**	**15,833**
Over 5 years through 10 years	**27,860**	**28,403**	**8,455**	**8,272**
Over 10 years	**2,219**	**2,313**		
Mortgage-backed securities, residential	**49,089**	**51,586**	**53,085**	**52,811**
CRA mutual fund	**1,044**	**1,051**		
Stock in other banks	**627**	**756**		
	$ 118,380	**$ 122,938**	**$ 77,593**	**$ 76,916**

The Corporation realized gross gains of $52,000 and $0 in gross losses on sales of securities available for sale during the three and six month periods ended June 30, 2014. The Corporation did not realize any gross gains or losses on sales of securities available for sale during the three and six month period ended June 30, 2013.

At June 30, 2014, and December 31, 2013, securities with a carrying value of $125,593,000 and $139,966,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements, and for other purposes.

8. **Loans**

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

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

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

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

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

Allowance for Credit Losses

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

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

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

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

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

- the nature and volume of the portfolio and terms of loans;
- the experience, ability and depth of lending management and staff;
- the volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

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

The unallocated component of the allowance is maintained to cover uncertainties that could affect management s estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. It covers risks that are inherently difficult to quantify including, but not limited to, collateral risk, information risk, and historical charge-off risk.

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

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

It is the policy of the Corporation to order an updated valuation on all real estate secured loans when the loan becomes 90 days past due and there has not been an updated valuation completed within the previous 12 months. In addition, the Corporation orders third-party valuations on all impaired real estate collateralized loans within 30 days of the loan being classified as impaired. Until the valuations are completed, the Corporation utilizes the most recent independent third-party real estate valuation to estimate the need for a specific allocation to be assigned to the loan. These existing valuations are discounted downward to account for such things as the age of the existing collateral valuation, change in the condition of the real estate, change in local market and economic conditions, and other specific factors involving the collateral. Once the updated valuation is completed, the collateral value is updated accordingly.

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

The Corporation actively monitors the values of collateral as well as the age of the valuation of impaired loans. Management believes that the Corporation s market area is not as volatile as other areas throughout the United States, therefore valuations are ordered at least every 18 months, or more frequently if management believes that there is an indication that the fair value has declined.

For impaired loans secured by collateral other than real estate, the Corporation considers the net book value of the collateral, as recorded in the most recent financial statements of the borrower, and determines fair value based on estimates made by management.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In underwriting one-to-four family residential real estate loans, the Corporation evaluates both the borrower s financial ability to repay the loan as agreed and the value of the property securing the loan. Properties securing real estate loans made by the Corporation are appraised by independent appraisers. The Corporation generally requires borrowers to obtain an attorney s title opinion or title insurance, as well as fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. The Corporation has not engaged in subprime residential mortgage originations.

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

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

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

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

Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market continues to be weak and property values deteriorate.

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

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

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

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard, and doubtful within the Corporation s internal risk rating system as of June 30, 2014, and December 31, 2013:

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
JUNE 30, 2014					
Commercial and industrial	**$ 54,945**	**$ 2,484**	**$ 3,766**	**$**	**$ 61,195**
Commercial real estate	**211,239**	**25,548**	**14,220**		**251,007**
Commercial real estate construction	**7,754**	**3,535**	**2,418**		**13,707**
Residential mortgage	**349,474**	**3,476**	**2,336**		**355,286**
Home equity lines of credit	**52,338**	**797**	**35**		**53,170**
Consumer	**14,932**				**14,932**
	$ 690,682	**$ 35,840**	**$ 22,775**	**$**	**$ 749,297**
DECEMBER 31, 2013					
Commercial and industrial	$ 53,316	$ 2,364	$ 3,537	$	$ 59,217
Commercial real estate	193,162	29,655	16,369		239,186
Commercial real estate construction	5,123	5,018	1,055		11,196
Residential mortgage	344,847	2,551	3,611		351,009
Home equity lines of credit	53,021	608	223		53,852
Consumer	14,188				14,188
	$ 663,657	$ 40,196	$ 24,795	$	$ 728,648

The following table summarizes information relative to impaired loans by loan portfolio class as of June 30, 2014, and December 31, 2013:

	Impaired Loans with Allowance			Impaired Loans with No Allowance	
In thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
JUNE 30, 2014					
Commercial and industrial	**$**	**$**	**$**	**$ 311**	**$ 1,425**
Commercial real estate				**10,464**	**10,775**
Commercial real estate construction				**709**	**984**
Residential mortgage	**964**	**1,002**	**260**	**327**	**327**
	$ 964	**$ 1,002**	**$ 260**	**$ 11,811**	**$ 13,511**
DECEMBER 31, 2013					
Commercial and industrial	$	$	$	$ 1,574	$ 2,688
Commercial real estate				11,197	11,758
Commercial real estate construction				788	1,062
Residential mortgage	1,478	1,478	201	675	712
	$ 1,478	$ 1,478	$ 201	$ 14,234	$ 16,220

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the three months ended June 30, 2014 and 2013:

	Impaired Loans with Allowance		Impaired Loans with No Allowance	
In thousands	Average Recorded Investment	Interest Income	Average Recorded Investment	Interest Income
JUNE 30, 2014				
Commercial and industrial	**$**	**$**	**$ 833**	**$**
Commercial real estate	**180**		**10,295**	**82**
Commercial real estate construction			**749**	
Residential mortgage	**1,252**	**9**	**386**	**4**
	$ 1,432	**$ 9**	**$ 12,263**	**$ 86**
JUNE 30, 2013				
Commercial and industrial	$ 73	$	$ 191	$
Commercial real estate	119		12,176	93
Commercial real estate construction	4,955	60	821	
Residential mortgage	1,344		883	3
	$ 6,491	$ 60	$ 14,071	$ 96

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the six months ended June 30, 2014 and 2013:

	Impaired Loans with Allowance		Impaired Loans with No Allowance	
In thousands	**Average Recorded Investment**	**Interest Income**	**Average Recorded Investment**	**Interest Income**
JUNE 30, 2014				
Commercial and industrial	**$**	**$**	**$ 1,080**	**$**
Commercial real estate	**241**		**10,476**	**330**
Commercial real estate construction			**762**	
Residential mortgage	**1,401**	**9**	**408**	**8**
	$ 1,642	**$ 9**	**$ 12,726**	**$ 338**
JUNE 30, 2013				
Commercial and industrial	$ 97	$	$ 193	$
Commercial real estate	158		11,041	359
Commercial real estate construction	3,303	135	832	
Residential mortgage	896		902	6
	$ 4,454	$ 135	$ 12,968	$ 365

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

The following table presents nonaccrual loans by loan portfolio class as of June 30, 2014, and December 31, 2013:

In thousands	**June 30, 2014**	**December 31, 2013**
Commercial and industrial	**$ 311**	$ 1,574
Commercial real estate	**3,709**	4,363
Commercial real estate construction	**709**	788
Residential mortgage	**993**	1,848
	$ 5,722	$ 8,573

The following table summarizes information relative to troubled debt restructurings by loan portfolio class as of June 30, 2014, and December 31, 2013:

In thousands	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment at Period End
JUNE 30, 2014			
Nonaccruing troubled debt restructurings:			
Commercial and industrial	**$ 490**	**$ 485**	**$ 90**
Commercial real estate	**1,021**	**1,021**	**590**
Commercial real estate construction	**1,548**	**1,541**	**616**
Total nonaccruing troubled debt restructurings	**3,059**	**3,047**	**1,296**
Accruing troubled debt restructurings:			
Commercial real estate	**7,118**	**7,170**	**6,754**
Residential mortgage	**336**	**336**	**299**
Total accruing troubled debt restructurings	**7,454**	**7,506**	**7,053**
Total Troubled Debt Restructurings	**$ 10,513**	**$ 10,553**	**$ 8,349**
DECEMBER 31, 2013			
Nonaccruing troubled debt restructurings:			
Commercial and industrial	$ 490	$ 485	$ 142
Commercial real estate	1,021	1,021	634
Commercial real estate construction	1,548	1,541	694
Residential mortgage	566	566	566
Total nonaccruing troubled debt restructurings	3,625	3,613	2,036
Accruing troubled debt restructurings:			
Commercial real estate	7,118	7,170	6,834
Residential mortgage	336	336	305
Total accruing troubled debt restructurings	7,454	7,506	7,139
Total Troubled Debt Restructurings	$ 11,079	$ 11,119	$ 9,175

All of the Corporation s troubled debt restructured loans are also impaired loans, of which some have resulted in a specific allocation and, subsequently, a charge-off as appropriate. During the three and six months ended June 30, 2014, there were no defaulted troubled debt restructured loans. One troubled debt restructured loan paid in full during the second quarter of 2014. During the three and six months ended June 30, 2013, one troubled debt restructured loan defaulted in the amount of $237,000. All other troubled debt restructured loans were current with respect to their associated forbearance agreement as of June 30, 2013. One forbearance agreement was negotiated during 2009 and modified during 2011, two were negotiated during 2010 and modified during 2013, three were negotiated during 2012, and one was negotiated during 2013.

There are forbearance agreements on all loans currently classified as troubled debt restructurings, except for two loans in which the forbearance agreement has expired and one loan in which a modification took place, all of which remain classified as troubled debt restructured loans. All of these troubled debt restructured loans have resulted in additional principal repayment. The terms of these troubled debt restructured loans vary whereby principal payments have been decreased, interest rates have been reduced, and/or the loan will be repaid as collateral is sold.

The following table summarizes loans whose terms have been modified resulting in troubled debt restructurings during the three and six months ended June 30, 2014 and 2013:

Dollars in thousands	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Recorded Investment at Period End
THREE MONTHS ENDED JUNE 30, 2014				
Troubled debt restructurings		**$**	**$**	**$**
SIX MONTHS ENDED JUNE 30, 2014				
Troubled debt restructurings		**$**	**$**	**$**
THREE MONTHS ENDED JUNE 30, 2013				
Troubled debt restructurings		$	$	$
SIX MONTHS ENDED JUNE 30, 2013				
Troubled debt restructurings:				
Commercial real estate	1	$ 2,541	$ 2,593	$ 2,593

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

The following table presents the classes of the loan portfolio summarized by the past due status as of June 30, 2014, and December 31, 2013:

In thousands	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
JUNE 30, 2014							
Commercial and industrial	**$ 1,986**	**$**	**$ 318**	**$ 2,304**	**$ 58,891**	**$ 61,195**	**$ 7**
Commercial real estate	**239**	**702**	**1,942**	**2,883**	**248,124**	**251,007**	**36**
Commercial real estate construction			**709**	**709**	**12,998**	**13,707**	
Residential mortgage	**247**	**958**	**2,351**	**3,556**	**351,730**	**355,286**	**1,386**
Home equity lines of credit	**68**	**51**	**214**	**333**	**52,837**	**53,170**	**214**
Consumer	**21**	**1**		**22**	**14,910**	**14,932**	
	$ 2,561	**$ 1,712**	**$ 5,534**	**$ 9,807**	**$ 739,490**	**$ 749,297**	**$ 1,643**
DECEMBER 31, 2013							
Commercial and industrial	$ 55	$ 13	$ 152	$ 220	$ 58,997	$ 59,217	$ 3
Commercial real estate	857	552	1,964	3,373	235,813	239,186	
Commercial real estate construction			788	788	10,408	11,196	
Residential mortgage	4,728	795	3,148	8,671	342,338	351,009	1,900
Home equity lines of credit	260	36	14	310	53,542	53,852	14
Consumer	22	15	9	46	14,142	14,188	9
	$ 5,922	$ 1,411	$ 6,075	$ 13,408	$ 715,240	$ 728,648	$ 1,926

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

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF AND FOR THE PERIOD ENDED JUNE 30, 2014								
Allowance for Loan Losses								
Beginning balance - April 1, 2014	**$ 1,798**	**$ 5,831**	**$ 207**	**$ 3,740**	**$ 525**	**$ 952**	**$ 3,106**	**$ 16,159**
Charge-offs	**(23)**	**(111)**		**(151)**	**(121)**	**(4)**		**(410)**
Recoveries	**4**			**7**		**3**		**14**
Provisions	**185**	**(258)**	**18**	**333**	**125**	**47**	**(450)**	
Ending balance - June 30, 2014	**$ 1,964**	**$ 5,462**	**$ 225**	**$ 3,929**	**$ 529**	**$ 998**	**$ 2,656**	**$ 15,763**
Beginning balance - January 1, 2014	**$ 1,915**	**$ 5,819**	**$ 247**	**$ 4,013**	**$ 537**	**$ 947**	**$ 2,613**	**$ 16,091**
Charge-offs	**(57)**	**(111)**		**(173)**	**(121)**	**(40)**		**(502)**
Recoveries	**12**			**7**		**5**		**24**
Provisions	**94**	**(246)**	**(22)**	**82**	**113**	**86**	**43**	**150**
Ending balance - June 30, 2014	**$ 1,964**	**$ 5,462**	**$ 225**	**$ 3,929**	**$ 529**	**$ 998**	**$ 2,656**	**$ 15,763**
Ending balance: individually evaluated for impairment	**$**	**$**	**$**	**$ 260**	**$**	**$**	**$**	**$ 260**
Ending balance: collectively evaluated for impairment	**$ 1,964**	**$ 5,462**	**$ 225**	**$ 3,669**	**$ 529**	**$ 998**	**$ 2,656**	**$ 15,503**
Loans Receivable								
Ending balance	**$ 61,195**	**$ 251,007**	**$ 13,707**	**$ 355,286**	**$ 53,170**	**$ 14,932**	**$**	**$ 749,297**
Ending balance: individually evaluated for impairment	**$ 311**	**$ 10,464**	**$ 709**	**$ 1,291**	**$**	**$**	**$**	**$ 12,775**
Ending balance: collectively evaluated for impairment	**$ 60,884**	**$ 240,543**	**$ 12,998**	**$ 353,995**	**$ 53,170**	**$ 14,932**	**$**	**$ 736,522**
AS OF AND FOR THE PERIOD ENDED JUNE 30, 2013								
Allowance for Loan Losses								
Beginning Balance - April 1, 2013	$ 1,562	$ 6,244	$ 2,101	$ 4,083	$ 516	$ 665	$ 2,315	$ 17,486
Charge-offs	(56)	(109)		(482)		(106)		(753)
Recoveries	5					1		6
Provisions	(41)	(283)	(559)	548	15	266	554	500
Ending balance - June 30, 2013	$ 1,470	$ 5,852	$ 1,542	$ 4,149	$ 531	$ 826	$ 2,869	$ 17,239
Beginning Balance - January 1, 2013	$ 1,507	$ 6,576	$ 518	$ 3,721	$ 517	$ 633	$ 3,353	$ 16,825
Charge-offs	(92)	(144)		(596)		(129)		(961)
Recoveries	221			1		3		225
Provisions	(166)	(580)	1,024	1,023	14	319	(484)	1,150
Ending balance - June 30, 2013	$ 1,470	$ 5,852	$ 1,542	$ 4,149	$ 531	$ 826	$ 2,869	$ 17,239
Ending balance: individually evaluated for impairment	$	$	$ 1,306	$ 370	$	$	$	$ 1,676
Ending balance: collectively evaluated for impairment	$ 1,470	$ 5,852	$ 236	$ 3,779	$ 531	$ 826	$ 2,869	$ 15,563
Loans Receivable								

Ending balance	$	46,572	$	237,473	$	14,523	$	334,799	$	52,897	$	14,332	$	$ 700,596
Ending balance: individually evaluated for impairment	$	187	$	12,587	$	5,314	$	2,124	$		$		$	$ 20,212
Ending balance: collectively evaluated for impairment	$	46,385	$	224,886	$	9,209	$	332,675	$	52,897	$	14,332	$	$ 680,384

AS OF DECEMBER 31, 2013								
Ending balance	$ 1,915	$ 5,819	$ 247	$ 4,013	$ 537	$ 947	$ 2,613	$ 16,091
Ending balance: collectively evaluated for impairment	$ 1,915	$ 5,819	$ 247	$ 3,812	$ 537	$ 947	$ 2,613	$ 15,890
Loans Receivable								
Ending balance: individually evaluated for impairment	$ 1,574	$ 11,197	$ 788	$ 2,153	$	$	$	$ 15,712

9. **Fair Value Measurements**

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

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

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

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

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

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

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

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

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

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis of measurement used, at June 30, 2014, and December 31, 2013, are as follows:

		June 30, 2014			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		**$ 19,539**	**$**	**$ 19,539**	**$**
Mortgage-backed securities, residential		**51,586**		**51,586**	
State and municipal		**39,871**		**39,871**	
Corporate bonds		**10,135**		**10,135**	
CRA mutual fund		**1,051**	**1,051**		
Stock in other banks		**756**	**756**		
Total securities available for sale	**Recurring**	**$ 122,938**	**$ 1,807**	**$ 121,131**	**$**
Impaired loans	**Nonrecurring**	**$ 6,032**	**$**	**$**	**$ 6,032**
Foreclosed assets held for resale	**Nonrecurring**	**$ 159**	**$**	**$**	**$ 159**

		December 31, 2013			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		$ 21,651	$	$ 21,651	$
Mortgage-backed securities, residential		53,740		53,740	
State and municipal		41,522		41,522	
Corporate bonds		11,165		11,165	
CRA mutual fund		1,033	1,033		
Stock in other banks		872	872		
Total securities available for sale	Recurring	$ 129,983	$ 1,905	$ 128,078	$
Impaired loans	Nonrecurring	$ 6,887	$	$	$ 6,887
Foreclosed assets held for resale	Nonrecurring	$ 413	$	$	$ 413

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

	Quantitative Information about Level 3 Fair Value Measurements				
Dollars in thousands	**Fair Value Estimate**	**Valuation Technique**	**Unobservable Input**	**Range**	**Weighted Average**
June 30, 2014					
Impaired loans	**$ 6,032**	**Appraisal of collateral (a)**	**Appraisal adjustments (b)**	**(10) - (50)%**	**(18)%**
Foreclosed assets held for resale	**$ 159**	**Appraisal of collateral (a)**	**Appraisal adjustments (b)**	**(10) - (50)%**	**(18)%**
December 31, 2013					
Impaired loans	$ 6,887	Appraisal of collateral (a)	Appraisal adjustments (b)	(10) - (50)%	(19)%
Foreclosed assets held for resale	$ 413	Appraisal of collateral (a)	Appraisal adjustments (b)	(10) - (50)%	(35)%

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

(b) Appraisals may be adjusted downward by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percentage of the appraisal. Higher downward adjustments are caused by negative changes to the collateral or conditions in the real estate market, actual offers or sales contracts received, and/or age of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of certain Corporation financial instruments at June 30, 2014, and December 31, 2013:

Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the consolidated statement of condition for cash and short-term instruments approximate those assets fair value. U.S. currency is Level 1 and cash equivalents are Level 2.

Securities

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

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

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

Loans (Carried at Cost)

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

Impaired Loans (Generally Carried at Fair Value)

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

Foreclosed Assets Held for Resale

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

It is the policy of the Corporation to have the initial market value of a foreclosed asset held for resale determined by an independent third-party valuation. If the Corporation already has a valid appraisal on file for the property and that appraisal has been completed within the previous 12 months, another appraisal shall not be required when the Corporation acquires ownership of that real estate. Further, the Corporation shall update the market value of each foreclosed asset with an independent third-party valuation at least every 18 months, or more frequently if management believes that there is an indication that the fair value has declined. These valuations may be adjusted downward to account for specialized use of the property, change in the condition of the real estate, change in local market and economic conditions, and other specific factors involving the collateral.

Restricted Investment in Bank Stock (Carried at Cost)

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

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amounts of accrued interest receivable and accrued interest payable approximate their fair value.

Deposits (Carried at Cost)

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

Short-Term Borrowings (Carried at Cost)

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

Long-Term Borrowings (Carried at Cost)

The fair values of Federal Home Loan Bank (FHLB) advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms, and remaining maturity. The prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Off-Balance Sheet Credit-Related Instruments

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

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Corporation s financial instruments as of June 30, 2014, and December 31, 2013:

	June 30, 2014				
In thousands	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets:					
Cash and due from banks	**$ 15,423**	**$ 15,423**	**$ 6,004**	**$ 9,419**	**$**
Interest-bearing deposits in banks	**13,703**	**13,703**	**13,703**		
Investment securities available for sale	**122,938**	**122,938**	**1,807**	**121,131**	
Investment securities held to maturity	**77,593**	**76,916**		**76,916**	
Loans, less allowance for loan losses	**733,534**	**747,475**			**747,475**
Accrued interest receivable	**2,923**	**2,923**		**2,923**	
Restricted investment in bank stocks	**5,439**	**5,439**		**5,439**	
Financial liabilities:					
Deposits	**821,276**	**822,144**		**822,144**	
Short-term borrowings	**42,202**	**42,202**		**42,202**	
Long-term borrowings	**76,572**	**78,272**		**78,272**	
Accrued interest payable	**683**	**683**		**683**	
Off-balance sheet financial instruments					

	December 31, 2013				
In thousands	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets:					
Cash and due from banks	$ 13,963	$ 13,963	$ 7,755	$ 6,208	$
Interest-bearing deposits in banks	4,153	4,153	4,153		
Investment securities available for sale	129,983	129,983	1,905	128,078	
Investment securities held to maturity	94,373	92,082		92,082	
Loans held for sale	496	496		496	
Loans, less allowance for loan losses	712,557	724,937			724,937
Accrued interest receivable	3,027	3,027		3,027	
Restricted investment in bank stocks	6,861	6,861		6,861	
Financial liabilities:					
Deposits	800,643	801,063		801,063	
Short-term borrowings	49,052	49,052		49,052	
Long-term borrowings	82,703	84,558		84,558	
Accrued interest payable	681	681		681	
Off-balance sheet financial instruments					

10. **Securities Sold Under Agreements to Repurchase (Repurchase Agreements)**

The Corporation enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Corporation may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Corporation to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing agreements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities.

The obligation to repurchase the securities is reflected as a liability in the Corporation s consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Corporation does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Corporation be in default (e.g., fails to make an interest payment to the counterparty). For private institution repurchase agreements, if the private institution counterparty were to default (e.g., declare bankruptcy), the Corporation could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third-party financial institution in the counterparty s custodial account. The counterparty has the right to sell or repledge the investment securities. For government entity repurchase agreements, the collateral is held by the Corporation in a segregated custodial account under a tri-party agreement.

The following table presents the short-term borrowings subject to an enforceable master netting arrangement or repurchase agreement as of June 30, 2014, and December 31, 2013:

				Gross Amounts Not Offset in the Statements of Condition		
In thousands	**Gross Amounts of Recognized Liabilities**	**Gross Amounts Offset in the Statements of Condition**	**Net Amounts of Liabilities Presented in the Statements of Condition**	**Financial Instruments**	**Cash Collateral Pledged**	**Net Amount**
June 30, 2014						
Repurchase agreements						
Commercial customers and government entities **(a)**	**$ 42,202**	**$**	**$ 42,202**	**$ (42,202)**	**$**	**$**
December 31, 2013						
Repurchase agreements						
Commercial customers and government entities (a)	$ 42,252	$	$ 42,252	$ (42,252)	$	$

(a) As of June 30, 2014, and December 31, 2013, the fair value of securities pledged in connection with repurchase agreements was $53,418,000 and $60,823,000, respectively.

11. **New Accounting Pronouncements**

ASU 2014-01

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2014-01, *Investments Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force).*

The Low-Income Housing Tax Credit is a program designed to encourage investment of private capital for use in the construction and rehabilitation of low-income housing, which provides certain tax benefits to investors in those projects. The amendments in this Update permit a reporting entity that invests in qualified affordable housing projects to account for the investments using a proportional amortization method if certain conditions are met. If the Corporation elects the proportional amortization method, it will amortize the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognize the net investment performance in the income statement as a component of income tax expense. Otherwise, the Corporation would apply either the equity method or the cost method, as appropriate.

The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. If adopted, the amendments should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments.

The Corporation is evaluating the effects this Update will have on its consolidated financial condition or results of operations.

ASU 2014-04

In January 2014, the FASB issued ASU 2014-04, *Receivables Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force).*

The Update clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement.

The amendments in this Update are effective for public business entities for annual periods and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. If adopted, an entity can elect to adopt the amendments in this Update using either a modified retrospective transition method or a prospective transition method.

The Corporation is evaluating the effects this Update will have on its consolidated financial condition or results of operations.

ASU 2014-11

In June 2014, the FASB issued ASU 2014-11, *Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures.*

The amendments in this Update require two accounting changes. First, repurchase-to-maturity transactions will be accounted for as secured borrowing transactions on the balance sheet, rather than sales. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with (or in contemplation of) a repurchase agreement with the same counterparty, which also will generally result in secured borrowing accounting for the repurchase agreement. The ASU introduces new disclosures to increase transparency about the types of collateral pledged for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings. The ASU also requires a transferor to disclose information about transactions accounted for as a sale in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets through an agreement with the transferee.

For public business entities, the accounting changes and disclosure for certain transactions accounted for as a sale are effective for the first interim or annual period beginning after December 15, 2014. The disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. All entities are required to present changes in accounting for transactions outstanding on the effective date as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Earlier application for a public business entity is prohibited. The disclosures are not required to be presented for comparative periods before the effective date.

The Corporation is evaluating the effects this Update will have on its consolidated financial condition or results of operations.

ACNB CORPORATION

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

INTRODUCTION AND FORWARD-LOOKING STATEMENTS

Introduction

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

Forward-Looking Statements

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

CRITICAL ACCOUNTING POLICIES

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

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

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

Accounting Standard Codification (ASC) Topic 350, *Intangibles Goodwill and Other*, requires that goodwill is not amortized to expense, but rather that it be assessed or tested for impairment at least annually. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. The Corporation did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of October 1, 2013. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested for impairment when such events occur. The Corporation has not identified any such events and, accordingly, has not tested goodwill for impairment during the six months ended June 30, 2014. Other acquired intangible assets with finite lives, such as customer lists, are required to be amortized over the estimated lives. These intangibles are generally amortized using the straight line method over estimated useful lives of ten years.

The Corporation recognizes deferred tax assets and liabilities for the future effects of temporary differences and tax credits. Enacted tax rates are applied to cumulative temporary differences based on expected taxable income in the periods in which the deferred tax asset or liability is anticipated to be realized. Future tax rate changes could occur that would require the recognition of income or expense in the consolidated statements of income in the period in which they are enacted. Deferred tax assets must be reduced by a valuation allowance if in management s judgment it is more likely than not that some portion of the asset will not be realized. Management may need to modify their judgments in this regard from one period to another should a material change occur in the business environment, tax legislation, or in any other business factor that could impair the Corporation s ability to benefit from the asset in the future.

RESULTS OF OPERATIONS

Quarter ended June 30, 2014, compared to quarter ended June 30, 2013

Executive Summary

Net income for the three months ended June 30, 2014, was $2,731,000, compared to $2,322,000 for the same quarter in 2013, an increase of $409,000 or 17.6%. Earnings per share was $0.46 in 2014 and $0.38 in 2013. Net interest income increased $82,000, or 1.0%, as decreases in total interest income were exceeded by decreases in total interest expense. Provision for loan losses decreased $500,000, or 100.0%, based on the adequacy analysis of the allowance for loan losses calculation at the end of each period; resulting in an allowance to total loans of 2.10% at June 30, 2014. Other income increased $252,000, or 8.0%, due primarily to higher revenue from fiduciary activities and the insurance subsidiary, offsetting lower deposit account fees and lower fees from mortgage sales. Other expenses increased $203,000, or 2.5%, due in part to higher marketing expenditures and the costs to carry and dispose of foreclosed assets held for resale.

Net Interest Income

Net interest income totaled $8,420,000 for the quarter ended June 30, 2014, compared to $8,338,000 for the same period in 2013, an increase of $82,000 or 1.0%. Net interest income increased due to the decrease in interest income being less than the decrease in interest expense, both resulting from reductions in market rates associated with the continued low interest rates maintained by the Federal Reserve Bank and the general interest rate environment. Interest income decreased $31,000, or less than 1.0%. This decrease is more nominal than in recent quarters as the mix of earning assets changed to higher yielding loans versus investment securities in the second quarter of 2014. The recent year trend of interest income decreases are due to declines in the Federal Funds Target Rate and other market driver rates. These driver rates affect new loan originations and are indexed to a portion of the loan portfolio in that a decrease in the driver rates decreases the yield on new loans and on existing loans at subsequent interest rate reset dates. In this manner, interest income will be negatively affected as new loans replace paydowns on existing loans and variable rate loans reset to new lower rates. In addition, interest income was lower on investment securities as paydowns were not reinvested due to much lower market rates as a result of uneven domestic and international economic conditions. An appropriate but lower amount of earning assets have been left in short-term, low-rate money market type accounts during the second quarter of 2014, because of increased loan demand and ample ability to borrow at low rates for liquidity needs. As to funding costs, interest rates on alternative funding sources, such as the Federal Home Loan Bank (FHLB), and other market driver rates are factors in rates the Corporation and the local market pay for deposits. However, during the second quarter of 2014, several of the core deposit rates continued at practical floors after the Federal Open Market Committee decreased the Federal Funds Target Rate by 400 basis points during 2008 and has maintained it at 0% to 0.25% since that time.

Interest expense decreased $113,000, or 11.1%. For more information about interest rate risk, please refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K for the fiscal year ended December 31, 2013, and filed with the SEC on March 7, 2014. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the second quarter of 2014 was 3.45% compared to 3.38% during the same period in 2013. Also comparing the second quarter of 2014 to 2013, the yield on interest earning assets increased by 0.01% and the cost of interest bearing liabilities decreased by 0.05%. The net interest margin was 3.53% for the second quarter of 2014 and 3.47% for the second quarter of 2013. The net interest margin increase was mainly a result of an improved mix of loans in earning assets offsetting the continued decline in the yield on assets to a greater degree than the decline in funding rates (due to funding rates approaching practical floors on deposits as described above).

Average earning assets were $969,924,000 during the second quarter of 2014, an increase of $3,842,000 from the average for the second quarter of 2013. Average interest bearing liabilities were $802,259,000 in the second quarter of 2014, an increase of $2,983,000 from the same quarter in 2013.

Provision for Loan Losses

The provision for loan losses was $0 in the second quarter of 2014 compared to $500,000 in the second quarter of 2013, a decrease of $500,000 or 100.0%. The decrease was a result of analysis of the adequacy of the allowance for loan losses calculation. More specifically, nonaccrual loans decreased 31.5% and the remaining substandard loans decreased by 14.0%. As a result of management s analysis based on independent appraisals, adequate collateralization exists for these loans in accordance with GAAP. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors. For more information, please refer to *Allowance for Loan Losses* in the following Financial Condition section of this Management s Discussion and Analysis of Financial Condition and Results of Operations. ACNB charges confirmed loan losses to the allowance and credits the allowance for recoveries of previous loan charge-offs. For the second quarter of 2014, the Corporation had net charge-offs of $396,000, as compared to net charge-offs of $747,000 for the second quarter of 2013.

Other Income

Total other income was $3,392,000 for the three months ended June 30, 2014, up $252,000, or 8.0%, from the second quarter of 2013. Fees from deposit accounts decreased by $15,000, or 2.7%, due to decreased volume. Fee volume varies with balance levels, account transaction activity, and customer-driven events such as overdrawing account balances. Various specific government regulations effectively limit fee assessments related to deposit accounts, making future revenue levels uncertain. Revenue from ATM and debit card transactions increased 12.4% to $400,000 due to higher volume. The current increase resulted from consumer desire to use more electronic delivery channels; however, regulations or legal challenges for large financial institutions may impact industry pricing for such transactions and fees in connection therewith in future periods, the effect of which cannot be currently quantified. Another challenge to this revenue source is the security breaches in the merchant base that can affect consumer confidence in the debit card channel. Income from fiduciary activities, which include both institutional and personal trust and investment management services, totaled $411,000 for the three months ended June 30, 2014, as compared to $312,000 for the second quarter of 2013, a 31.7% increase as a result of higher estate fee income, which is inherently sporadic in nature, and higher fee volume from increased assets under management. Earnings on bank-owned life insurance increased by $35,000, or 13.8%, as a result of the purchase of additional policies in 2014. At the Corporation s wholly-owned insurance subsidiary, Russell Insurance Group, Inc. (RIG), revenue was up by $133,000, or 9.5%, to $1,532,000 due to higher contingent commissions offsetting nonrenewal of a select number of large commercial accounts and actions by insurance carriers to reduce commissions paid to agencies such as RIG. Contingent or extra commission payments from insurance carriers are mostly received in the first half of each year, and the amount is at the discretion of the insurance carriers in

accordance with applicable insurance regulations. Heightened pressure on commissions is expected to continue in this business line from insurance company actions, and contingent commissions are not predictable. Other income in the quarter ended June 30, 2014, was down by $96,000, or 35.4%, to $175,000 due to decreased fees related to sales of residential mortgages which reflects industry-wide decreased refinancing activity.

Impairment Testing

RIG has certain long-lived assets, including purchased intangible assets subject to amortization, such as insurance books of business, and associated goodwill assets, which are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the statement of condition and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Goodwill, which has an indefinite useful life, is evaluated for impairment annually and is evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. Recent changes to accounting rules 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. The goodwill impairment analysis currently used by the Corporation is a two-step test. The first step, used to identify potential impairment, involves comparing the reporting unit s estimated fair value to its carrying value, including goodwill. If the estimated fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. At the last test, commissions from insurance sales were up, although RIG s stand alone net income decreased because of startup costs of a new business line and earned incentive payments. The testing for potential impairment involved methods that include both current and projected income amounts, and the fair value remained above the carrying value as of the annual impairment test date. Therefore, the results of the annual evaluations to date have determined that there is no impairment of goodwill, including the most recent testing at October 1, 2013. However, future declines in RIG s net income or changes in external market factors, including likely buyers that are assumed in impairment testing, may require an impairment charge to goodwill.

Other Expenses

The largest component of other expenses is salaries and employee benefits, which increased by $90,000, or 1.9%, when comparing the second quarter of 2014 to the same quarter a year ago. Overall, the increase in salaries and employee benefits was the result of:

- increases from merit-based pay increases and performance-based incentive accruals for employees;
- increased payroll taxes including higher unemployment tax assessments;
- health insurance, covering a substantial portion of employees, which increased due to rate and participation;
- increased costs associated with benefit plans other than the qualified pension plan; all partially offset by,

- decreased defined benefit pension expense, which was down by $233,000, when comparing the three months ended June 30, 2014, to June 30, 2013, resulting from higher investment performance in 2013 (which affects subsequent year expense) and an increase in the discount rate which lowered the future pension obligations at the latest valuation.

The Corporation s overall pension plan investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation s risk tolerance on contribution levels, funded status, plan expense, as well as any applicable regulatory requirements. However, the determination of future benefit expense is also dependent on the fair value of assets and the discount rate on the year-end measurement date, which in recent years has experienced fair value volatility and low discount rates. The Corporation amended the defined benefit pension plan effective April 1, 2012, in that no employee hired after March 31, 2012, shall be eligible to participate in the plan and no inactive or former plan participant shall be eligible to again participate in the plan. The ACNB plan has maintained a well-funded status.

Net occupancy expense decreased by $3,000, or 0.6%, mostly due to various expense controls. Equipment expense decreased by $115,000, or 14.5%, as a result of the budgeted replacement of outdated technology devices expensed in 2013, causing that year to be increased.

Professional services expense totaled $270,000 for the second quarter of 2014, as compared to $191,000 for the same period in 2013, an increase of $79,000 or 41.4%. The increase was due to higher expenses related to corporate governance, risk and compliance management engagements, and legal counsel matters in connection with loans.

Marketing and corporate relations expenses were $91,000, or 80.5%, higher in the second quarter of 2014, as compared to the same period of 2013. Marketing expense varies with the timing and amount of budgeted advertising production and media expenditures, typically related to the promotion of certain in-market banking and trust products. Some of the increase in 2014 was also related to a new office location.

Foreclosed assets held for resale consist of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. Foreclosed real estate expense (income) was $74,000 and $(72,000) for the quarters ended June 30, 2014 and 2013, respectively. The higher cost in the second quarter of 2014 was primarily due to transfer costs including unpaid taxes for three additional properties acquired in the second quarter of 2014. The net recovery in the second quarter 2013 was the sale of one property (that had incurred considerable expenses in prior periods) offsetting the expenses of a number of other properties. Otherwise, the expense varies based upon the number and mix of commercial and residential real estate properties, unpaid property taxes, and deferred maintenance required upon acquisition. In addition, some properties suffer decreases in value after acquisition, requiring write-downs to fair value during the prolonged marketing cycles for these distressed properties. Foreclosed assets held for resale expenses or recoveries will vary in the remainder of 2014 depending on the successful closing of sales agreements on some existing properties and the unknown expenses related to new properties acquired.

Other tax expense decreased by $50,000, or 21.6%, due to varying rates on a state shareholders equity-based tax. Supplies and postage expense decreased by 35.1% in part due to variation in placing periodic large envelope reorders. Other operating expenses increased by $19,000, or 2.2%, in the second quarter of 2014, as compared to the second quarter of 2013. Increases included higher costs for electronic delivery channels, telecommunications, and corporate governance, as well as normal variations in a number of categories.

Provision for Income Taxes

The Corporation recognized income taxes of $861,000, or 24.0% of pretax income, during the second quarter of 2014, as compared to $639,000, or 21.6% of pretax income, during the same period in 2013. The variances from the federal statutory rate of 34% in both periods are generally due to tax-exempt income (from investments in and loans to state and local units of government at below-market rates, an indirect form of taxation, and investment in bank-owned life insurance) and investments in low-income housing partnerships (which qualify for federal tax credits). Tax-exempt investments have been allowed to run off due to concerns of interest rate risk related to these investments. The income tax provision during both the second quarters ended June 30, 2014 and 2013, included low-income housing tax credits of $169,000.

Six months ended June 30, 2014, compared to six months ended June 30, 2013

Executive Summary

Net income for the six months ended June 30, 2014, was $5,203,000, compared to $4,740,000 for the same six months in 2013, an increase of $463,000 or 9.8%. Earnings per share was $0.87 in 2014 and $0.79 in 2013. Net interest income decreased $35,000, or 0.2%, as decreases in total interest income were mostly matched by decreases in total interest expense. Provision for loan losses decreased $1,000,000, or 87.0%, based on the adequacy analysis of the allowance for loan losses at the end of each period. The allowance for loan losses stood at 2.10% of total loans as of June 30, 2014. Other income decreased $91,000, or 1.5%, due primarily to lower deposit account fees and lower fees from mortgage sales, partially offset by higher revenue from the insurance subsidiary and the fiduciary activities. Other expenses increased $129,000, or 0.8%, due primarily to a variety of offsetting changes in various expenses.

Net Interest Income

Net interest income totaled $16,837,000 for the six months ended June 30, 2014, compared to $16,872,000 for the same period in 2013, a decrease of $35,000 or 0.2%. Net interest income decreased due to a decline in interest income to a greater degree than the decrease in interest expense, both resulting from reductions in market rates associated with the continued low interest rates maintained by the Federal Reserve Bank and the general interest rate environment.

Interest income decreased $378,000, or 2.0%, despite the nonrecurring collection of $238,000 of all interest due on a paid-off loan that had been classified as nonaccrual status because of delinquency in prior years. Otherwise, the net decrease was due to declines in the Federal Funds Target Rate and other market driver rates. These driver rates affect new loan originations and are indexed to a portion of the loan portfolio in that a decrease in the driver rates decreases the yield on new loans and on existing loans at subsequent interest rate reset dates. In this manner, interest income will continue to decrease as new loans replace paydowns on existing loans and variable rate loans reset to new lower rates. In addition, interest income was lower as a result of investment securities paydowns that were reinvested at much lower market rates that were prevailing at the time of reinvestment due to uneven domestic and international economic conditions, compounded by Federal Reserve Bank buying activities referred to as Quantitative Easing which is currently winding down. A lower portion of earning assets have been left in short-term, low-rate money market type accounts during the first six months of 2014, because of increased loan demand and stable ability to borrow for liquidity needs. As to funding costs, interest rates on alternative funding sources, such as the Federal Home Loan Bank (FHLB), and other market driver rates are factors in rates the Corporation and the local market pay for deposits. However, during the first half of 2014, several of the core deposit rates continued at practical floors after the Federal Open Market Committee decreased the Federal Funds Target Rate by 400 basis points during 2008 and has maintained it at 0% to 0.25% since that time. Interest expense decreased $343,000, or 16.0%. For more information about interest rate risk, please refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K for the fiscal year ended December 31, 2013, and filed with the SEC on March 7, 2014. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the first six months of 2014 and 2013 was 3.45%. Also comparing the first six months of 2014 to 2013, the yield on interest earning assets and the cost of interest bearing liabilities decreased by 0.08%. The net interest margin was 3.52% (3.48% without the one-time interest recoveries) for the first six months of 2014 and 3.53% for the same period in 2013. The net interest margin decline was mainly a result of the rate of decline in the yield on assets decreasing to a greater degree than the decline in funding rates due to funding rates approaching practical floors on deposits as described above.

Average earning assets were $965,595,000 during the first six months of 2014, an increase of $951,000 from the average for the first six months of 2013. Average interest bearing liabilities were $803,058,000 in the first six months of 2014, a decrease of $683,000 from the same six months in 2013.

Provision for Loan Losses

The provision for loan losses was $150,000 in the first six months of 2014 compared to $1,150,000 in the first six months of 2013, a decrease of $1,000,000 or 87.0%. The decrease was a result of analysis of the adequacy of the allowance for loan losses calculation. More specifically, nonaccrual loans decreased 31.5% and the remaining substandard loans decreased by 14.0%. As a result of management s analysis based on independent appraisals, adequate collateralization exists for these loans in accordance with GAAP. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors. For more information, please refer to *Allowance for Loan Losses* in the following Financial Condition section of this Management s Discussion and Analysis of Financial Condition and Results of Operations. ACNB charges confirmed loan losses to the allowance and credits the allowance for recoveries of previous loan charge-offs. For the first six months of 2014, the Corporation had net charge-offs of $478,000, as compared to net charge-offs of $736,000 for the first six months of 2013.

Other Income

Total other income was $5,994,000 for the six months ended June 30, 2014, down $91,000, or 1.5%, from the first six months of 2013. Fees from deposit accounts decreased by $88,000, or 8.1%, due to decreased volume. Fee volume varies with balance levels, account transaction activity, and customer-driven events such as overdrawing account balances. Various specific government regulations effectively limit fee

assessments related to deposit accounts, making future revenue levels uncertain. Revenue from ATM and debit card transactions increased 12.4% to $759,000 due to higher volume. The current increase resulted from consumer desire to use more electronic delivery channels; however, regulations or legal challenges for large financial institutions may impact industry pricing for such transactions and fees in connection therewith in future periods, the effect of which cannot be currently quantified. Another challenge to this revenue source is the security breaches in the merchant base that can affect consumer confidence in the debit card channel. Income from fiduciary activities, which include both institutional and personal trust and investment management services, totaled $737,000 for the six months ended June 30, 2014, as compared to $643,000 for the six months ended June 30, 2013, a 14.6% increase as a result of more estate fee income, which is inherently sporadic in nature, and higher fee volume from increased assets under management. Earnings on bank-owned life insurance increased by $49,000, or 9.9%, as a result of the purchase of additional policies in 2014.

At the Corporation s wholly-owned insurance subsidiary, Russell Insurance Group, Inc. (RIG), revenue was up by $67,000, or 2.6%, to $2,597,000 due to the higher contingency commission payments offsetting nonrenewal of a select number of large commercial accounts and actions by insurance carriers to reduce commissions paid to agencies such as RIG. Contingent or extra commission payments from insurance carriers are mostly received in the first half of each year, and the amount is at the discretion of the insurance carriers in accordance with applicable insurance regulations. Heightened pressure on commissions is expected to continue in this business line from insurance company actions, and contingent commissions are not predictable. Other income in the six months ended June 30, 2014, was down by $349,000, or 53.2%, to $307,000 due to decreased fees related to sales of residential mortgages as increases in market rates decreased refinancing activity.

Impairment Testing

RIG has certain long-lived assets, including purchased intangible assets subject to amortization, such as insurance books of business, and associated goodwill assets, which are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the statement of condition and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated.

Goodwill, which has an indefinite useful life, is evaluated for impairment annually and is evaluated for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset s fair value. Recent changes to accounting rules 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. The goodwill impairment analysis currently used by the Corporation is a two-step test. The first step, used to identify potential impairment, involves comparing the reporting unit s estimated fair value to its carrying value, including goodwill. If the estimated fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. At the last test, commissions from insurance sales were up, although RIG s stand alone net income decreased because of startup costs of a new business line and earned incentive payments. The testing for potential impairment involved methods that include both current and projected income amounts, and the fair value remained above the carrying value as of the annual impairment test date. Therefore, the results of the annual evaluations to date have determined that there is no impairment of goodwill, including the most recent testing at October 1, 2013. However, future declines in RIG s net income or changes in external market factors, including likely buyers that are assumed in impairment testing, may require an impairment charge to goodwill.

Other Expenses

The largest component of other expenses is salaries and employee benefits, which increased by $97,000, or 1.0%, when comparing the first six months of 2014 to the same period a year ago. Overall, the increase in salaries and employee benefits was the result of:

- increases from merit-based pay increases and performance-based incentive accruals for employees;
- increased payroll taxes including higher unemployment tax assessments;
- health insurance, covering a substantial portion of employees;
- increased costs associated with benefit plans other than the qualified pension plan; all partially offset by,

- decreased defined benefit pension expense, which was down by $465,000, when comparing the six months ended June 30, 2014, to June 30, 2013, resulting from higher investment performance in 2013 (which affects subsequent year expense) and an increase in the discount rate which lowered the future pension obligations at the last valuation.

The Corporation s overall pension plan investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation s risk tolerance on contribution levels, funded status, plan expense, as well as any applicable regulatory requirements. However, the determination of future benefit expense is also dependent on the fair value of assets and the discount rate on the year-end measurement date, which in recent years has experienced fair value volatility and low discount rates. The Corporation amended the defined benefit pension plan effective April 1, 2012, in that no employee hired after March 31, 2012, shall be eligible to participate in the plan and no inactive or former plan participant shall be eligible to again participate in the plan. The ACNB plan has maintained a well-funded status.

Net occupancy expense increased by $66,000, or 6.5%, mostly due to higher weather-related costs in the first quarter of 2014. Equipment expense decreased by $130,000, or 9.0%, as a result of the budgeted replacement of outdated technology devices expensed in 2013, causing that year to be increased.

Professional services expense totaled $574,000 during the first six months of 2014, as compared to $435,000 for the same period in 2013, an increase of $139,000 or 32.0%. The increase was due to higher expenses related to corporate governance, risk and compliance management engagements, and legal counsel matters in connection with problem loans.

Marketing and corporate relations expenses were $89,000, or 42.0%, higher in the first six months of 2014, as compared to the same period of 2013. Marketing expense varies with the timing and amount of advertising production and media expenditures, typically related to the promotion of certain in-market banking and trust products.

Foreclosed assets held for resale consist of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. Foreclosed real estate expense (income) was $117,000 and $(93,000) for the six months ended June 30, 2014 and 2013, respectively. The higher cost in 2014 was primarily due to transfer costs including unpaid taxes for additional properties acquired in 2014. The net recovery in 2013 was the sale of one property (that had incurred considerable expenses in prior periods) offsetting the expenses of a number of other properties. Otherwise, the expense varies based upon the number and mix of commercial and residential real estate properties, unpaid property taxes, and deferred maintenance required upon acquisition. In addition, some properties suffer decreases in value after acquisition, requiring write-downs to fair value during the prolonged marketing cycles for these distressed properties. Foreclosed assets held for resale expenses or recoveries will vary in the remainder of 2014 depending on the successful closing of sales agreements on some existing properties and the unknown expenses related to new properties acquired.

Other tax expense decreased by $99,000, or 21.1%, due to varying rates on a state shareholders equity-based tax. Supplies and postage expense decreased by 13.6% in part due to variation in placing periodic large envelope reorders. Other operating expenses decreased by $202,000, or 12.3%, in the first six months of 2014, as compared to the first six months of 2013. The decreases included one-time reductions associated with closing out a low-income housing project. Further activity in closing out another low-income housing project is expected to offset this one-time reduction later in 2014. Increases included higher costs for electronic delivery channels and telecommunications, as well as normal variations in a number of categories.

Provision for Income Taxes

The Corporation recognized income taxes of $1,576,000, or 23.2% of pretax income, during the first six months of 2014, as compared to $1,294,000, or 21.4% of pretax income, during the same period in 2013. The variances from the federal statutory rate of 34% in both periods are generally due to tax-exempt income from investments in and loans to state and local units of government at below-market rates (an indirect form of taxation), investment in bank-owned life insurance, and investments in low-income housing partnerships (which qualify for federal tax credits). Tax-exempt investments have been allowed to run off due to concerns of interest rate risk related to these investments. The income tax provision during the six months ended June 30, 2014 and 2013, included low-income housing tax credits of $339,000, respectively.

FINANCIAL CONDITION

Assets totaled $1,057,253,000 at June 30, 2014, compared to $1,046,047,000 at December 31, 2013, and $1,038,856,000 at June 30, 2013. Average earning assets during the six months ended June 30, 2014, increased to $965,595,000 from $964,644,000 during the same period in 2013. Average interest bearing liabilities decreased in 2014 to $803,058,000 from $803,741,000 in 2013, while average non-interest bearing deposits increased by $6,434,000.

Investment Securities

ACNB uses investment securities to generate interest and dividend income, manage interest rate risk, provide collateral for certain funding products, and provide liquidity. The changes in the securities portfolio were mainly to deploy available funds into the appropriate mix of earning assets. Investing into investment security portfolio assets over the last several years was made more challenging due to the Federal Reserve Bank s program commonly called Quantitative Easing in which, by the Federal Reserve s open market purchases, the yields are maintained at a lower level than would otherwise be the case. The investment portfolio is comprised of U.S. Government agency, municipal and corporate securities. These securities provide the appropriate characteristics with respect to credit quality, yield and maturity relative to the management of the overall balance sheet.

At June 30, 2014, the securities balance included a net unrealized gain on available for sale securities of $3,012,000, net of taxes, on amortized cost of $118,380,000 versus a net unrealized gain of $2,572,000, net of taxes, on amortized cost of $126,090,000 at December 31, 2013, and a net unrealized gain of $3,178,000, net of taxes, on amortized cost of $136,724,000 at June 30, 2013. The increase in fair value of securities during 2014 was the result of a decrease in the U.S. Treasury yield curve and the spread from this yield curve required by investors on the types of investment securities that ACNB owns. More specifically, comments by the Federal Reserve Chairman in late second quarter of 2013 caused a sharp spike in market rates which, in turn, lowered the value of most securities already owned at that time; since then, market rates have fluctuated and in 2014 were down. Previously, actions by the Federal Reserve to lower rates on the yield curve most conducive to stimulating the housing market and to boost employment and consumption offset the bond markets concern about the level of U.S. debt and inflation, leading to generally lower rates in the yield curve despite fair values being volatile on any given day in all periods presented.

At June 30, 2014, the securities balance included held to maturity securities with an amortized cost of $77,593,000 and a fair value of $76,916,000, as compared to an amortized cost of $94,373,000 and a fair value of $92,082,000 at December 31, 2013, and an amortized cost of $90,314,000 and a fair value of $88,351,000 at June 30, 2013. The held to maturity securities are U.S. government agency debentures and pass-through mortgage-backed securities in which the full payment of principal and interest is guaranteed; however, they were not classified as available for sale because of prevailing low interest rates at purchase. These securities are generally used as required collateral for certain eligible government accounts or repurchase agreements. Some are also held for possible pledging to access additional liquidity for banking subsidiary needs in the form of FHLB borrowings.

The Corporation does not own investments consisting of pools of Alt-A or subprime mortgages, private label mortgage-backed securities, or trust preferred investments.

The fair values of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or by matrix pricing (Level 2) which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses independent service providers to provide matrix pricing. Please refer to Note 7 Securities in the

Notes to Consolidated Financial Statements for more information on the security portfolio and Note 9 Fair Value Measurements in the Notes to Consolidated Financial Statements for more information about fair value.

Loans

Loans outstanding increased by $48,701,000, or 7.0%, from June 30, 2013, to June 30, 2014, and increased by $20,649,000, or 2.8%, from December 31, 2013, to June 30, 2014. The year-over-year increase in loan volume was the result of determined efforts to lend to creditworthy borrowers subject to the Corporation s disciplined underwriting standards, despite the continued slow economic conditions and intense competition. The smaller increase in the first six months of 2014 was caused by seasonal factors. In all periods, residential real estate lending and refinance activity was slow and commercial loans were subject to refinancing elsewhere for better rates or more lenient terms. More payoffs are anticipated in the remainder of 2014 from either customers cash reserves or refinancing at competing banks. Nonetheless, during the first six months of 2014, commercial purpose loans increased, while local market portfolio residential mortgages increased at a lower growth rate. Commercial purpose segments increased $16,310,000, or 4.6%, as compared to December 31, 2013.

These loans are spread among diverse categories that include commercial real estate, commercial real estate construction, and commercial and industrial. Residential real estate mortgage lending, which includes smaller commercial purpose loans secured by the owner s home, increased by $3,595,000, or 0.9%, as compared to December 31, 2013. These loans are to local borrowers who preferred loan types that would not be sold into the secondary mortgage market. Of the $408,456,000 total in residential mortgage loans at June 30, 2014, $83,981,000 were secured by junior liens or home equity loans, which are also in many cases junior liens. Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a senior security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market weakens and property values deteriorate.

Most of the Corporation s lending activities are with customers located within southcentral Pennsylvania and in the northern Maryland area that is contiguous to its Pennsylvania retail banking offices. This region currently and historically has lower unemployment than the U.S. as a whole. Included in commercial real estate loans are loans made to lessors of non-residential properties that total $115,770,000, or 14.4% of total loans, at June 30, 2014. These borrowers are geographically dispersed throughout ACNB s marketplace and are leasing commercial properties to a varied group of tenants including medical offices, retail space, and other commercial purpose facilities. Because of the varied nature of the tenants, in aggregate, management believes that these loans present an acceptable risk when compared to commercial loans in general. ACNB does not originate or hold Alt-A or subprime mortgages in its loan portfolio.

Allowance for Loan Losses

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

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

- adverse situations that may affect the borrower s ability to repay;
- the current estimated fair value of underlying collateral; and,
- prevailing market conditions.

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

loan pool. Additionally, management adjusts projected loss ratios for other factors, including the following:

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

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

- the risk of imprecision in the specific and general reserve allocations;

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

- other potential exposure in the loan portfolio;

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

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

The unallocated portion of the allowance is deemed to be appropriate as it reflects an uncertainty that remains in the loan portfolio, as well as a Corporation-specific and industry-wide hesitancy to prematurely release reserves at this time as the Corporation believes that additional losses are probable. The Corporation has determined that the amount of provision in 2014 and the resulting allowance at June 30, 2014, are appropriate given the continuing level of risk in the loan portfolio.

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

Management bases the provision for loan losses, or lack of provision, on the overall analysis taking into account the methodology discussed above. The provision for year-to-date June 30, 2014, was $1,000,000 less than the provision for year-to-date June 30, 2013. More specifically, even though total loans increased, provision expense decreased because of the decrease in substandard loans, as well as the fact that most impaired credits were, in the opinion of management, adequately collateralized. Management believes that the decrease in the provision reflects that potential losses inherent in the portfolio were reflected in previous period provision expense and is consistent with recent improving credit quality in the loan portfolio.

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

The allowance for loan losses at June 30, 2014, was $15,763,000, or 2.10% of loans, as compared to $17,239,000, or 2.46% of loans, at June 30, 2013, and $16,091,000, or 2.21% of loans, at December 31, 2013.

Changes in the allowance for loan losses were as follows:

In thousands	Six Months Ended June 30, 2014	Year Ended December 31, 2013	Six Months Ended June 30, 2013
Beginning balance - January 1	**$ 16,091**	$ 16,825	$ 16,825
Provisions charged to operations	**150**	1,450	1,150
Recoveries on charged-off loans	**24**	243	225
Loans charged-off	**(502)**	(2,427)	(961)
Ending balance	**$ 15,763**	$ 16,091	$ 17,239

Loans past due 90 days and still accruing were $1,643,000 and nonaccrual loans were $5,722,000 as of June 30, 2014. $1,296,000 of the nonaccrual balance at June 30, 2014, was in troubled debt restructured loans. $7,053,000 of the impaired loans were accruing troubled debt restructured loans. Loans past due 90 days and still accruing were $2,128,000 at June 30, 2013, while nonaccruals were $8,358,000. $1,549,000 of the nonaccrual balance at June 30, 2013, was in troubled debt restructured loans. $7,328,000 of the impaired loans were accruing troubled debt restructured loans. Loans past due 90 days and still accruing were $1,926,000 at December 31, 2013, while nonaccruals were $8,573,000. $2,036,000 of the nonaccrual balance at December 31, 2013, was in troubled debt restructured loans. $7,139,000 of the impaired loans were accruing troubled debt restructured loans.

Total additional loans classified as substandard (potential problem loans) at June 30, 2014, June 30, 2013, and December 31, 2013, were approximately $10,000,000, $11,043,000 and $9,083,000, respectively.

Information on nonaccrual loans, by collateral type rather than loan class, at June 30, 2014, as compared to December 31, 2013, is as follows:

Dollars in thousands	Number of Credit Relationships	Balance	Specific Loss Allocations	Current Year Charge-Offs	Location	Originated
June 30, 2014						
Residential real estate developments	**2**	**$ 709**	**$**	**$**	**In market**	**2006 - 2010**
Owner occupied commercial real estate and construction	**13**	**3,709**		**160**	**In market**	**1995 - 2012**
Investment/rental commercial real estate	**4**	**993**	**260**	**72**	**In market**	**2003 - 2011**
Commercial and industrial	**3**	**311**			**In market**	**2006 - 2007**
Total	**22**	**$ 5,722**	**$ 260**	**$ 232**		
December 31, 2013						
Residential real estate developments	3	$ 1,010	$	$ 214	In market	2006 - 2009
Owner occupied commercial real estate	17	6,439	101	109	In market	1995 - 2011
Investment/rental commercial real estate	4	975	100	634	In market	1998 - 2011
Commercial and industrial	2	149		22	In market	2007 - 2008
Total	26	$ 8,573	$ 201	$ 979		

Management deemed it appropriate to provide this type of more detailed information by collateral type in order to provide additional detail on the loans.

All nonaccrual impaired loans are to borrowers located within the market area served by the Corporation in southcentral Pennsylvania and nearby areas of northern Maryland. All nonaccrual impaired loans were originated by ACNB s banking subsidiary, except for one participation loan discussed below, between 1995 and 2012 for purposes listed in the classifications in the table above.

Included in residential real estate developments at June 30, 2014, the Corporation had one impaired and nonaccrual loan of $616,000 to finance a project in the Corporation s primary trading area of southcentral Pennsylvania. The loan has standard terms and conditions, including repayment from the sales of the respective properties and no interest reserves, and was originated during the first half of 2006. Foreclosure has been held in abeyance while allowing the pursuit of a workout plan including providing additional collateral and more targeted marketing of the property. This loan was charged-down by $274,000 in the first quarter of 2011 due to declines in fair value, and subsequently additional paydowns were made by the borrower from sales of collateral. Because of the 2011 write-down and subsequent principal repayment, there was no specific valuation allowance on this loan at June 30, 2014. One smaller residential real estate development loan, added in 2010, was reduced by collateral sales to $93,000, which is supported by the remaining collateral s current fair value. Another smaller residential real estate development relationship, added in 2013 after the borrower filed Chapter 13 bankruptcy, was not fully supported by the collateral s fair value because of a dispute on a prior lien. The relationship totaled $436,000 prior to charge-offs of $214,000 taken in 2013 on confirmed losses based on new appraisals. Title to one parcel was obtained in the first quarter of 2014, and the fair value less costs to sell amount of $160,000 was reclassified as foreclosed assets held for resale. Legal action continues on resolving the issues on this credit. The respective allowances, write-downs, and charge-offs were derived by estimating the cash flow from the sale of the property given the respective stage of completion.

Owner occupied commercial real estate and construction at June 30, 2014, includes 13 unrelated loan relationships, all of which but a loan relationship for farmland have balances of less than $625,000 each, for which the real estate is collateral and is used in connection with a business enterprise that is suffering economic stress or is out of business. The farmland relationship with an outstanding balance of $917,000, with normal terms and conditions, was added to nonaccrual in the second quarter of 2013 after the loan matured and the borrower commenced a bankruptcy filing.

Based on recent appraisals, the loan appears to be adequately collateralized. The other loans in this category were originated between 1995 and 2012 and are business loans impacted by the general economic downturn that has not recovered. Collection efforts will continue until it is deemed in the best interest of the Corporation to initiate foreclosure procedures. A credit with a balance of $562,000 and specific allocation of $79,000 was settled with a payoff and a $49,000 charge-off in the second quarter of 2014. A first quarter 2014 specific allocation of $111,000 was charged off in the second quarter on an unrelated $361,000 loan after the Corporation accepted a third-party sale (proceeds are yet to be released by the court) rather than to take physical possession of real estate with possible environmental problems.

Investment/rental commercial real estate at June 30, 2014, includes four unrelated loan relationships totaling $993,000, of which one loan was approximately $734,000, for which the real estate is collateral and the purpose of which is for speculation, rental, or other non-owner occupied uses. The $734,000 credit was added in the first quarter of 2013 and has a specific allocation of $226,000 after an interim partial charge-off of $101,000 in 2013. All of these loans were originated between 2003 and 2011. The loans were each affected by the lack of borrower cash flow to continue to service the debt and, in some cases, by increased real estate taxes levied by local government units. The plan is to enter foreclosure proceedings and subsequently market the real estate if ongoing workout efforts are not successful. A smaller credit relationship previously had a $7,000 specific allocation on a $134,000 balance, but $72,000 was charged off on moving to foreclosed properties in the second quarter due to hidden damage. Another loan with a balance of $167,000 and a specific allocation of $13,000 is scheduled for sheriff s sale in July 2014.

Included in impaired commercial and industrial loans at June 30, 2014, is a fully-disbursed line of credit, originated in the second quarter of 2007 for a start-up enterprise in the food industry in southcentral Pennsylvania, totaling $90,000 with no specific valuation allowance at June 30, 2014, which is net of a $1,000,000 charge-off taken in 2008 and an additional charge-off of $529,000 in 2011. In the third quarter of 2011, the borrower entered into an addendum to a prior delinquent forbearance agreement with all required principal forbearance payments made by the borrower to date. This loan, with standard terms and conditions including repayment from conversion of trade assets, continues in default and in nonaccrual status. One participation loan was added to the impaired category in the fourth quarter of 2013 and had an outstanding participation balance of $218,000 at June 30, 2014, after receipt of $1,207,000 in payments in the first half of 2014 from liquidation of collateral. The participation commercial and industrial loan, for a business in southcentral Pennsylvania with normal terms and conditions, was purchased in 2005 and remains adequately secured by real estate, despite a late 2013 borrower s bankruptcy filing and uncertain values on inventory and accounts receivable.

The Corporation utilizes a systematic review of its loan portfolio on a quarterly basis in order to determine the adequacy of the allowance for loan losses. In addition, ACNB engages the services of an outside independent loan review function and sets the timing and coverage of loan reviews during the year. The results of this independent loan review are included in the systematic review of the loan portfolio. The allowance for loan losses consists of a component for individual loan impairment, primarily based on the loan s collateral fair value and expected cash flow. A watch list of loans is identified for evaluation based on internal and external loan grading and reviews. Loans other than those determined to be impaired are grouped into pools of loans with similar credit risk characteristics. These loans are evaluated as groups with allocations made to the allowance based on historical loss experience adjusted for current trends in delinquencies, trends in underwriting and oversight, concentrations of credit, and general economic conditions within the Corporation s trading area. The provision expense was based on the loans discussed above, as well as current trends in the watch list and the local economy as a whole. The charge-offs discussed elsewhere in this management s discussion and analysis create the recent loss history experience and result in the qualitative adjustment which, in turn, affects the calculation of losses inherent in the portfolio. The provision for loan losses for 2014 and 2013 was a result of the measurement of the adequacy of the allowance for loan losses at each period. The decrease in the provision was also a result of the analysis of the adequacy of the allowance for loan losses. More specifically, nonaccrual loans decreased and provision expense decreased due to the amount of the allowance necessary in proportion to substandard loans in accordance with management s belief that adequate collateralization generally exists for substandard loans in accordance with GAAP. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors.

Foreclosed Assets Held for Resale

Foreclosed assets held for resale consists of the fair value of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. These fair values become the Corporation s new cost basis. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. The carrying value of real estate acquired through foreclosure totaled $1,486,000 for 10 properties to unrelated borrowers at June 30, 2014, compared to $1,762,000 for nine properties at December 31, 2013.

The decrease in the carrying value was due to asset values of five properties that were added, less four sold, in 2014. All properties are actively being marketed. The Corporation expects to obtain and market additional foreclosed assets through the remainder of 2014; however, the total amount and timing is currently not certain.

Deposits

ACNB relies on deposits as a primary source of funds for lending activities with total deposits of $821,276,000 as of June 30, 2014. Deposits decreased by $5,109,000, or 0.6%, from June 30, 2013, to June 30, 2014, and increased by $20,633,000, or 2.6%, from December 31, 2013, to June 30, 2014. Deposits vary between quarters mostly reflecting different levels held by local government and school districts during different times of the year. Despite the overall increase since 2013, a decrease was experienced in certificate of deposit (CD) balances as market-priced CD products were not attractive compared to alternative investments such as equity securities. ACNB s deposit pricing function employs a disciplined pricing approach based upon alternative funding rates, but also strives to price deposits to be competitive with relevant local competition, including credit unions and larger regional banks. During the recession and subsequent slow recovery, deposit growth mix experienced a shift to transaction accounts as customers put more value in liquidity and FDIC insurance. Products, such as money market accounts and interest-bearing transaction accounts that had suffered declines in past years, continued with recovered balances; however, more recent trends suggest a return to more normal, lower balances. With persistent low market interest rates in a slow economy, ACNB s ability to maintain and add to its deposit base may be impacted by the reluctance of consumers to accept low rates and by competition willing to pay above market rates to attract market share. Alternatively, if rates rise rapidly and the equity markets continue to improve, funds could leave the Corporation or be priced higher to maintain similar levels.

Borrowings

Short-term borrowings are comprised primarily of securities sold under agreements to repurchase and short-term borrowings from the FHLB. As of June 30, 2014, short-term borrowings were $42,202,000, as compared to $49,052,000 at December 31, 2013, and $51,250,000 at June 30, 2013. Agreements to repurchase accounts are within the commercial customer base and have attributes similar to core deposits. Investment securities are pledged in sufficient amounts to collateralize these agreements. In comparison to year-end 2013, repurchase agreement balances were down $50,000, or 0.1%, due to changes in the cash flow position of ACNB s commercial and local government customer base. There were $0 and $6,800,000 in short-term FHLB borrowings at June 30, 2014, and December 31, 2013, respectively. Short-term FHLB borrowings are used to even out funding from seasonality in the deposit base. Long-term borrowings consist primarily of longer-term advances from the FHLB that contribute to a more balanced net repricing position; in addition, this category includes a loan from a commercial bank to fund the purchase of RIG with a remaining balance of $1,572,000. Long-term borrowings totaled $76,572,000 at June 30, 2014, versus $82,703,000 at December 31, 2013, and $52,830,000 at June 30, 2013. The Corporation increased long-term borrowings from June 30, 2013, to fund loan demand that was in excess of the amount available from deposits. Additional laddered FHLB fixed-rate term advances were taken in the fourth quarter of 2013 and first half of 2014 to reduce net liability sensitivity and to take advantage of lower rates. Further borrowings will be used when necessary for a variety of risk management and funding purposes. Please refer to the *Liquidity* discussion below for more information on the Corporation s ability to borrow.

Capital

ACNB s capital management strategies have been developed to provide an appropriate rate of return to stockholders, while maintaining its well-capitalized position. Total stockholders equity was $110,454,000 at June 30, 2014, compared to $106,802,000 at December 31, 2013, and $101,796,000 at June 30, 2013. Stockholders equity increased in the first six months of 2014 by $3,652,000 due in part to $2,925,000 in earnings retained in capital and a $460,000 increase in accumulated other comprehensive income primarily as a result of appreciation in the fair value of the investment portfolio. Other comprehensive income or loss is mainly caused by fixed-rate investment securities gaining or losing value in

different interest rate environments and changes in the net funded position of the defined benefit pension plan.

The primary source of additional capital to ACNB is earnings retention, which represents net income less dividends declared. During the first six months of 2014, ACNB earned $5,203,000 and paid dividends of $2,278,000 for a dividend payout ratio of 43.8%. During the first six months of 2013, ACNB earned $4,740,000 and paid dividends of $2,268,000 for a dividend payout ratio of 47.8%.

ACNB Corporation has a Dividend Reinvestment and Stock Purchase Plan that provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. Year-to-date June 30, 2014, 14,035 shares were issued under this plan with proceeds in the amount of $267,000.

Year-to-date June 30, 2013, 15,648 shares were issued under this plan with proceeds in the amount of $268,000. Proceeds are used for general corporate purposes.

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

Quantitative measures established by regulation to ensure capital adequacy require ACNB to maintain minimum amounts and ratios of total and Tier 1 capital to average assets. Management believes, as of June 30, 2014, and December 31, 2013, that ACNB s banking subsidiary met all minimum capital adequacy requirements to which it is subject and is categorized as well capitalized . There are no subsequent conditions or events that management believes have changed the banking subsidiary s category.

Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). The phase-in period for community banking organizations begins January 1, 2015, while larger institutions (generally those with assets of $250 billion or more) were required to begin compliance effective January 1, 2014. The final rules call for the following capital requirements:

- a minimum ratio of common Tier 1 capital to risk-weighted assets of 4.5%;
- a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%;
- a minimum ratio of total capital to risk-weighted assets of 8.0%, which is no change from the current rule; and,
- a minimum leverage ratio of 4.0%.

In addition, the final rules establish a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations will begin on January 1, 2016.

Under the proposed rules, accumulated other comprehensive income (AOCI) would have been included in a banking organization s common equity Tier 1 capital. The final rules allow community banks to make a one-time election not to include these additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. The opt-out election must be made in the first call report or FR Y-9 series report that is filed after the financial institution becomes subject to the final rule.

The final rules permanently grandfather non-qualifying capital instruments (such as trust preferred securities and cumulative perpetual preferred stock) issued before May 19, 2010, for inclusion in the Tier 1 capital of banking organizations with total consolidated assets of less than $15 billion as of December 31, 2009, and banking organizations that were mutual holding companies as of May 19, 2010.

The proposed rules would also have modified the risk-weight framework applicable to residential mortgage exposures to require banking organizations to divide residential mortgage exposures into two categories in order to determine the applicable risk weight. In response to commenter concerns about the burden of calculating the risk weights and the potential negative effect on credit availability, the final rules do not adopt the proposed risk weights but retain the current risk weights for mortgage exposures under the general risk-based capital rules.

Consistent with Dodd-Frank, the new rules replace the ratings-based approach to securitization exposures, which is based on external credit ratings, with the simplified supervisory formula approach in order to determine the appropriate risk weights for these exposures.

Alternatively, banking organizations may use the existing gross-up approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250 percent risk weight.

Under the new rules, mortgage servicing assets and certain deferred tax assets are subject to stricter limitations than those applicable under the current general risk-based capital rule. The new rules also increase the risk weights for past due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

The Corporation is in the process of assessing the impact of these changes on the regulatory ratios of the Corporation and the banking subsidiary, as well as on the capital, operations, liquidity and earnings of the Corporation and the banking subsidiary.

Risk-Based Capital

The banking subsidiary s capital ratios are as follows:

	June 30, 2014	December 31, 2013	To Be Well Capitalized Under Prompt Corrective Action Regulations
Tier 1 leverage ratio (to average assets)	**8.90%**	8.76%	5.00%
Tier 1 risk-based capital ratio (to risk-weighted assets)	**12.99%**	12.99%	6.00%
Total risk-based capital ratio	**14.25%**	14.26%	10.00%

Liquidity

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

ACNB s funds are available from a variety of sources, including assets that are readily convertible such as interest bearing deposits with banks, maturities and repayments from the securities portfolio, scheduled repayments of loans receivable, the core deposit base, and the ability to borrow from the FHLB. At June 30, 2014, ACNB s banking subsidiary had a borrowing capacity of approximately $425,740,000 from the FHLB, of which $350,740,000 was available. Because of various restrictions and requirements on utilizing the available balance, ACNB considers $244,000,000 to be the practicable additional borrowing capacity, which is considered to be sufficient for operational needs. The FHLB system is self-capitalizing, member-owned, and its member banks stock is not publicly traded. ACNB creates its borrowing capacity with the FHLB by granting a security interest in certain loan assets with requisite credit quality. ACNB has reviewed information on the FHLB system and the FHLB of Pittsburgh, and has concluded that they have the capacity and intent to continue to provide both operational and contingency liquidity. The FHLB of Pittsburgh instituted a requirement that a member s investment securities must be moved into a safekeeping account under FHLB control to be considered in the calculation of maximum borrowing capacity. The Corporation currently has securities in safekeeping at the FHLB of Pittsburgh; however, the safekeeping account is under the Corporation s control. As better contingent liquidity is maintained by keeping the securities under the Corporation s control, the Corporation has not moved the securities which, in effect, lowered the Corporation s maximum borrowing capacity. However, there is no practical reduction in borrowing capacity as the securities can be moved into the FHLB-controlled account promptly if they are needed for borrowing purposes.

Another source of liquidity is securities sold under repurchase agreements to customers of ACNB s banking subsidiary totaling approximately $42,202,000 and $42,252,000 at June 30, 2014, and December 31, 2013, respectively. These agreements vary in balance according to the cash flow needs of customers and competing accounts at other financial organizations.

The liquidity of the parent company also represents an important aspect of liquidity management. The parent company s cash outflows consist principally of dividends to stockholders and corporate expenses. The main source of funding for the parent company is the dividends it receives from its subsidiaries. Federal and state banking regulations place certain legal restrictions and other practicable safety and soundness restrictions on dividends paid to the parent company from the subsidiary bank.

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

Off-Balance Sheet Arrangements

The Corporation is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and, to a lesser extent, standby letters of credit. At June 30, 2014, the Corporation had unfunded outstanding commitments to extend credit of approximately $208,600,000 and outstanding standby letters of credit of approximately $4,009,000. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements.

Market Risks

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

RECENT DEVELOPMENTS

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

Holding Company Capital Requirements

Dodd-Frank requires the Federal Reserve to apply consolidated capital requirements to bank holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010, by a bank holding company with less than $15 billion in assets as of December 31, 2009. Dodd-Frank additionally requires that bank regulators issue countercyclical capital requirements so that the required amount of capital increases in times of economic expansion, consistent with safety and soundness.

Deposit Insurance

Dodd-Frank permanently increased the maximum deposit insurance amount for banks, savings institutions, and credit unions to $250,000 per depositor. Dodd-Frank also broadens the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. Dodd-Frank requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Dodd-Frank eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

Corporate Governance

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

Prohibition Against Charter Conversions of Troubled Institutions

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

Interstate Branching

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

Limits on Interstate Acquisitions and Mergers

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

Limits on Interchange Fees

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

Consumer Financial Protection Bureau

Dodd-Frank created the independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act, and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB, but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to

prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower s ability to repay. In addition, Dodd-Frank allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a qualified mortgage as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE - Pursuant to Dodd-Frank as highlighted above, the CFPB issued a final rule on January 10, 2013 (effective on January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine the consumer s ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and, (8) credit history. Alternatively, the mortgage lender can originate qualified mortgages , which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a qualified mortgage is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage, the points and fees paid by a consumer cannot exceed 3% of the total loan amount.

Loans which meet these criteria will be considered qualified mortgages and, as a result, generally protect lenders from fines or litigation in the event of foreclosure. Qualified mortgages that are higher-priced (e.g., subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not higher-priced (e.g., prime loans) are given a safe harbor of compliance. The impact of the final rule, and the subsequent amendments thereto, on the Corporation s lending activities and the Corporation s statements of income or condition are uncertain at this time; however, management will continue to monitor the implementation of the rule for any potential effects on the Corporation s business.

SUPERVISION AND REGULATION

Dividends

ACNB is a legal entity separate and distinct from its subsidiary bank. ACNB s revenues, on a parent company only basis, result primarily from dividends paid to the Corporation by its subsidiaries. Federal and state laws regulate the payment of dividends by ACNB s subsidiary bank. For further information, please refer to *Regulation of Bank* below.

Regulation of Bank

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

The Pennsylvania Department of Banking and Securities, which has primary supervisory authority over banks chartered in Pennsylvania, regularly examines banks in such areas as reserves, loans, investments, management practices, and other aspects of operations. The subsidiary bank is also subject to examination by the FDIC for safety and soundness, as well as consumer compliance. These examinations are designed for the protection of the subsidiary bank s depositors rather than ACNB s stockholders. The subsidiary bank must file quarterly and annual reports to the Federal Financial Institutions Examination Council, or FFIEC.

Monetary and Fiscal Policy

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

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Management monitors and evaluates changes in market conditions on a regular basis. Based upon the most recent review, management has determined that there have been no material changes in market risks since year-end 2013. For further discussion of year-end information, please refer to the Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

ITEM 4 - CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this report, the Corporation carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation s disclosure controls and procedures are effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in periodic SEC filings.

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

There were no changes in the Corporation s internal control over financial reporting during the quarterly period ended June 30, 2014, that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

PART II - OTHER INFORMATION

ACNB CORPORATION

ITEM 1 - LEGAL PROCEEDINGS

As of June 30, 2014, there were no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which ACNB or its subsidiaries are a party or by which any of their property is the subject. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation or its subsidiaries by governmental authorities.

ITEM 1A - RISK FACTORS

Management has reviewed the risk factors that were previously disclosed in the Annual Report on Form 10-K for the fiscal year-ended December 31, 2013. There are no material changes in the risk factors as previously disclosed in the Form 10-K.

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

On November 3, 2008, the Corporation announced a plan to purchase up to 120,000 shares of its outstanding common stock. There were no treasury shares purchased under this plan during the quarter ended June 30, 2014. The maximum number of shares that may yet be purchased under this stock repurchase plan is 57,400.

On May 5, 2009, stockholders approved and ratified the ACNB Corporation 2009 Restricted Stock Plan, effective as of February 24, 2009, in which awards shall not exceed, in the aggregate, 200,000 shares of common stock. As of June 30, 2014, there were no shares of common stock granted as restricted stock awards to either employees or directors. The Corporation s Registration Statement under the Securities Act of 1933 on Form S-8 for the ACNB Corporation 2009 Restricted Stock Plan was filed with the Securities and Exchange Commission on January 4, 2013.

On May 5, 2009, stockholders approved and adopted the amendment to the Articles of Incorporation of ACNB Corporation to authorize up to 20,000,000 shares of preferred stock, par value $2.50 per share. As of June 30, 2014, there were no issued or outstanding shares of preferred stock.

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

ITEM 4 - MINE SAFETY DISCLOSURES - NOT APPLICABLE.

ITEM 5 - OTHER INFORMATION - NOTHING TO REPORT.

ITEM 6 - EXHIBITS

The following exhibits are included in this report:

Exhibit 3(i)	Articles of Incorporation of ACNB Corporation, as amended. (Incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 2, 2009.)
Exhibit 3(ii)	Bylaws of ACNB Corporation, as amended. (Incorporated by reference to Exhibit 3.2 of the Registrant s Current Report on Form 8-K, filed with the Commission on February 4, 2013.)
Exhibit 10.1	ACNB Corporation, ACNB Acquisition Subsidiary LLC, and Russell Insurance Group, Inc. Stock Purchase Agreement. (Incorporated by reference to Exhibit 10.2 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
Exhibit 10.2	Salary Continuation Agreement Applicable to Ronald L. Hankey. (Incorporated by reference to Exhibit 10.2 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
Exhibit 10.3	Executive Supplemental Life Insurance Plan Applicable to Ronald L. Hankey, Thomas A. Ritter, David W. Cathell, Lynda L. Glass and James P. Helt. (Incorporated by reference to Exhibit 10.3 of the Registrant s Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the Commission on November 7, 2008.)
Exhibit 10.4	Director Supplemental Life Insurance Plan Applicable to Frank Elsner III, Scott L. Kelley, James J. Lott, Robert W. Miller, Donna M. Newell, J. Emmett Patterson, Daniel W. Potts, Marian B. Schultz, David L. Sites, Alan J. Stock, Harry L. Wheeler and James E. Williams. (Incorporated by reference to Exhibit 10.5 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
Exhibit 10.5	Amended and Restated Director Deferred Fee Plan Applicable to Frank Elsner III, Scott L. Kelley, James J. Lott, Robert W. Miller, Donna M. Newell, J. Emmett Patterson, Marian B. Schultz, David L. Sites, Alan J. Stock, Harry L. Wheeler and James E. Williams. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on January 6, 2012.)
Exhibit 10.6	ACNB Bank Salary Savings Plan. (Incorporated by reference to Exhibit 10.6 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Commission on March 12, 2010.)
Exhibit 10.7	Group Pension Plan for Employees of ACNB Bank. (Incorporated by reference to Exhibit 10.7 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the Commission on May 4, 2012.)
Exhibit 10.8	Complete Settlement Agreement and General Release made among ACNB Corporation, Adams County National Bank and John W. Krichten effective June 13, 2006. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 15, 2006.)
Exhibit 10.9	Employment Agreement between ACNB Corporation, Adams County National Bank and Thomas A. Ritter dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.9 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
Exhibit 10.10	Employment Agreement between ACNB Corporation, Adams County National Bank and Lynda L. Glass dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.10 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)

Exhibit 10.11	Employment Agreement between ACNB Corporation, Russell Insurance Group, Inc. and Frank C. Russell, Jr. dated as of January 13, 2011. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on January 19, 2011.)
Exhibit 10.12	Employment Agreement between ACNB Corporation, Adams County National Bank and David W. Cathell dated as of April 17, 2009. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 23, 2009.)
Exhibit 10.13	2009 Restricted Stock Plan. (Incorporated by reference to Appendix C of the Registrant s Proxy Statement on Schedule 14A, filed with the Commission on March 25, 2009.)
Exhibit 10.14	Salary Continuation Agreement by and between ACNB Bank and Thomas A. Ritter dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.15	Salary Continuation Agreement by and between ACNB Bank and Lynda L. Glass dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.2 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.16	Salary Continuation Agreement by and between ACNB Bank and David W. Cathell dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.3 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.17	Amended and Restated 2001 Salary Continuation Agreement by and between ACNB Bank and Thomas A. Ritter dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.4 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.18	Amended and Restated 1996 Salary Continuation Agreement by and between ACNB Bank and Lynda L. Glass dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.5 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.19	Employment Agreement between Adams County National Bank and James P. Helt dated as of April 15, 2009. (Incorporated by reference to Exhibit 10.19 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Commission on March 7, 2014.)
Exhibit 10.20	Salary Continuation Agreement by and between ACNB Bank and James P. Helt dated as of March 28, 2012. (Incorporated by reference to Exhibit 10.20 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Commission on March 7, 2014.)
Exhibit 11	Statement re Computation of Earnings. (Incorporated by reference to page 7 of this Form 10-Q.)
Exhibit 14	Code of Ethics. (Incorporated by reference to Exhibit 14 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2012, filed with the Commission on March 15, 2013.)
Exhibit 16.1	Correspondence from ParenteBeard LLC to the Securities and Exchange Commission dated July 11, 2013. (Incorporated by reference to Exhibit 16.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on July 15, 2013.)
Exhibit 18	Preferability Letter from ParenteBeard LLC dated as of August 3, 2012. (Incorporated by reference to Exhibit 18 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, filed with the Commission on August 3, 2012.)
Exhibit 31.1	Chief Executive Officer Certification of Quarterly Report on Form 10-Q.

Exhibit 31.2	Chief Financial Officer Certification of Quarterly Report on Form 10-Q.
Exhibit 32.1	Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.2	Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101.LAB	XBRL Taxonomy Extension Label Linkbase.
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase.
Exhibit 101.INS	XBRL Instance Document.
Exhibit 101.SCH	XBRL Taxonomy Extension Schema.
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase.
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase.

SIGNATURES

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

ACNB CORPORATION (Registrant)

Date: August 1, 2014

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

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