ACNB CORP
Form 10-K
March 15, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year-ended December 31, 2012

OR

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

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

ACNB CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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 ý 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 ý No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One)

Large accelerated filer o   Accelerated filer ý   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 Act). Yes o No ý

The aggregate market value of the voting stock held by nonaffiliates of the registrant at June 30, 2012, was approximately $84,546,197.

The number of shares of the registrant's common stock outstanding on March 8, 2013, was 5,965,368.

Documents Incorporated by Reference

Portions of the registrant's 2013 definitive Proxy Statement are incorporated by reference into Part III of this report.

ACNB CORPORATION

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PART I

FORWARD-LOOKING STATEMENTS

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

ITEM 1 BUSINESS

ACNB CORPORATION

ACNB Corporation (the Corporation or ACNB) is a $1.0 billion financial holding company headquartered in Gettysburg, Pennsylvania. Through its banking and nonbanking subsidiaries, ACNB provides a full range of banking and financial services to individuals and businesses, including commercial and retail banking, trust and investment management, and insurance. ACNB's banking operations are conducted through its primary operating subsidiary, ACNB Bank, with 19 retail banking offices in Adams, Cumberland and York Counties, Pennsylvania, as well as two loan production offices in York and Franklin Counties, Pennsylvania, as of December 31, 2012. The Corporation was formed in 1982, then became the holding company for Adams County National Bank (now ACNB Bank) in 1983.

On January 5, 2005, ACNB Corporation completed the acquisition of Russell Insurance Group, Inc. (RIG) and RIG began to operate as a separate subsidiary of ACNB Corporation. In accordance with the terms of the acquisition, there was contingent consideration associated with this transaction of up to $3,000,000, payable in 2008 subject to performance criteria for the three-year period subsequent to the acquisition. Due to performance at a higher level than the performance

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criteria, the liability for this consideration was recorded at December 31, 2006, with a related increase in goodwill. Payment was made in the second quarter of 2008 after it was ascertained that the performance criteria had been met for the full three-year period; after which, the total aggregate purchase price was $8,663,000. In addition, on January 13, 2011, the Corporation entered into another three-year employment agreement with Frank C. Russell, Jr., President & Chief Executive Officer of RIG, effective as of January 1, 2011.

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

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

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

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

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

BANKING SUBSIDIARY

ACNB Bank

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

ACNB Bank is a full-service commercial bank operating under charter from the Pennsylvania Department of Banking and Securities. The Bank's principal market area is Adams County, Pennsylvania, which is located in southcentral Pennsylvania. Adams County depends on agriculture, industry and tourism to provide employment for its residents. No single sector dominates the county's economy. At December 31, 2012, ACNB Bank had total assets of $1,035,000, total gross loans of $708,000,000, total deposits of $834,000,000, and total equity capital of $101,000,000.

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The main office of the Bank is located at 16 Lincoln Square, Gettysburg, Pennsylvania. In addition to its main office, as of December 31, 2012, the Bank had thirteen branches in Adams County, four branches in York County, and one branch in Cumberland County, as well as a loan production office in both York County and Franklin County, Pennsylvania. ACNB Bank's service delivery channels for its customers also include the ATM network, Customer Contact Center, and Online, Telephone, and Mobile Banking. The Bank is subject to regulation and periodic examination by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation (FDIC). The FDIC, as provided by law, insures the Bank's deposits.

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

A trust is a legal fiduciary agreement whereby the ACNB Bank Trust Department is named as trustee of financial assets. As trustee, the Trust Department invests, protects, manages and distributes financial assets as defined in the agreement. Estate settlement governed by the last will and testament of an individual constitutes another part of the Trust Department business. One purpose of having a will is to name an executor to settle the estate. ACNB Bank has the knowledge and expertise to act as executor. Other services include, but are not limited to, those related to testamentary trusts, life insurance trusts, charitable remainder trusts, guardianships, powers of attorney, custodial accounts, and investment management and advisory accounts. Total trust assets under management are approximately $141,000,000.

NONBANKING SUBSIDIARIES

Russell Insurance Group, Inc.

In January 2005, ACNB Corporation acquired Russell Insurance Group, Inc. (RIG), a full-service insurance agency that offers a broad range of property and casualty, life, and health insurance to both commercial and individual clients. Based in Westminster, Maryland, RIG has served the needs of its clients since its founding as an independent insurance agency by Frank C. Russell, Jr. in 1978. With the acquisition of Marks Insurance & Associates, Inc. as of December 31, 2008, RIG operates a second office location in Germantown, Maryland. Total assets of RIG as of December 31, 2012, were $11,733,000.

BankersRe Insurance Group, SPC

BankersRe Insurance Group, SPC (formerly Pennbanks Insurance Co., SPC) was organized in 2000 and holds an unrestricted Class "B" Insurer's License under Cayman Islands Insurance Law. The segregated portfolio was novated to a third party during 2012. This entity is not material to ACNB's financial condition or results of operations.

MARKET AREA ECONOMIC FEATURES AND CONDITIONS

ACNB Corporation, headquartered in Gettysburg, Pennsylvania, is the financial holding company for the wholly-owned subsidiaries of ACNB Bank, Gettysburg, Pennsylvania, and Russell Insurance Group, Inc., Westminster, Maryland. ACNB Bank serves its marketplace via a network of 19 retail banking offices located throughout Adams County, Pennsylvania, as well as in Dillsburg, Hanover and Spring Grove, York County, Pennsylvania, and in Newville, Cumberland County, Pennsylvania. In addition, the Bank operates loan offices in Hanover, York County, and Chambersburg, Franklin County, Pennsylvania. Russell Insurance Group, Inc. offers a broad range of commercial and personal insurance lines with licenses in 35 states, including Pennsylvania and Maryland, through offices in

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Westminster, Carroll County, and Germantown, Montgomery County, Maryland. Accordingly, ACNB Corporation's major operations are in the more rural areas of the Harrisburg-Carlisle MSA and the York-Hanover MSA, along with all of Adams County, Pennsylvania, and parts of Franklin County, Pennsylvania. Approximately 60% of the population resides in areas designated rural. Major types of employers include those focused on manufacturing, education, healthcare, agriculture, tourism, and transportation/warehousing, as well as local governments. A material amount of land surrounding Gettysburg is under the control of the National Park Service, limiting certain types of development. Unemployment figures recently, and historically, have been better than those for Pennsylvania and the United States. Per capita and household incomes are generally under Pennsylvania averages.

COMPETITION

The financial services industry in ACNB's market area is highly competitive, including competition for similar products and services from commercial banks, credit unions, finance and mortgage companies, and other nonbank providers of financial services. Several of ACNB's competitors have legal lending limits that exceed those of ACNB's subsidiary bank, as well as funding sources in the capital markets that exceed ACNB's availability. The increased competition has resulted from a changing legal and regulatory environment, as well as from the economic climate, customer expectations, and service alternatives via the Internet. There are 82 publicly traded banks in Pennsylvania, 15 have higher market share than ACNB. In addition, there are 18 thrift institutions and numerous credit unions in Pennsylvania, some with higher market share. Banks, thrifts, and credit unions in northern Maryland are also competition.

SUPERVISION AND REGULATION

Regulation of Bank Holding Company and Subsidiaries

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

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

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

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

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GRAMM-LEACH-BLILEY ACT OF 1999 (GLBA) The Gramm-Leach-Bliley Act of 1999 eliminated many of the restrictions placed on the activities of bank holding companies that become financial holding companies. Among other things, the Gramm-Leach-Bliley Act repealed certain Glass-Steagall Act restrictions on affiliations between banks and securities firms, and amended the Bank Holding Company Act to permit bank holding companies that are financial holding companies to engage in activities, and acquire companies engaged in activities, that are: financial in nature (including insurance underwriting, insurance company portfolio investment, financial advisory, securities underwriting, dealing and market-making, and merchant banking activities); incidental to financial activities; or, complementary to financial activities if the Federal Reserve determines that they pose no substantial risk to the safety or soundness of depository institutions or the financial system in general.

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

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

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

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

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

The SOA addresses, among other matters:

- Audit committees for all reporting companies;

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

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- The forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve-month period following initial publication of any financial statements that later require restatement;
- A prohibition on insider trading during pension plan blackout periods;
- Disclosure of off-balance sheet transactions;
- A prohibition on personal loans to directors and officers;
- Expedited filing requirements for SEC Forms 4;
- Disclosure of a code of ethics and filing an SEC Form 8-K for a change or waiver of such code;
- "Real time" filing of periodic reports;
- Formation of a public accounting oversight board;
- Auditor independence; and,
- Increased criminal penalties for violations of securities laws.

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

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

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

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (DODD-FRANK) In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. Dodd-Frank is intended to effect a fundamental restructuring of federal banking regulation. Among other things, Dodd-Frank created a new Financial Stability Oversight Council to identify systemic risks in the financial system and gives federal regulators new authority to take control of and liquidate financial firms. Dodd-Frank additionally created a new independent federal regulator to administer federal consumer protection laws. Dodd-Frank has and is expected to 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 Bank's interest expense. Among the provisions that are likely to affect ACNB are the following:

Holding Company Capital Requirements

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

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and soundness. For further information, please refer to *Capital* in Management's Discussion and Analysis.

Deposit Insurance

Dodd-Frank permanently increases the maximum deposit insurance amount for banks, savings institutions and credit unions to $250,000 per depositor, and extended unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012. Dodd-Frank also broadens the base for FDIC insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution. Dodd-Frank requires the FDIC to increase the reserve ratio of the Deposit Insurance Fund from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depository institutions when the reserve ratio exceeds certain thresholds. Effective one year from the date of enactment, on July 21, 2011, Dodd-Frank eliminated the federal statutory prohibition against the payment of interest on business checking accounts.

Corporate Governance

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

Prohibition Against Charter Conversions of Troubled Institutions

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

Interstate Branching

Dodd-Frank authorizes national and state banks to establish branches in other states to the same extent as a bank chartered by that state would be permitted. Previously, banks could only establish branches in other states if the host state expressly permitted out-of-state banks to establish branches in that state. Accordingly, banks 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 amends the Electronic Fund Transfer Act to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer.

Consumer Financial Protection Bureau

Dodd-Frank creates a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, 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 will allow borrowers to raise certain defenses to foreclosure if they receive any loan other than a "qualified mortgage" as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE Pursuant to the Dodd Frank Act, the Consumer Financial Protection Bureau 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 consumers' 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 final rule, as issued, is not expected to have a material impact on our lending activities and on our statements of income or condition.

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

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

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

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

- Taking such stock or securities as collateral for loans.

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

FEDERAL DEPOSIT INSURANCE CORPORATION IMPROVEMENT ACT OF 1991 (FDICIA) The Federal Deposit Insurance Corporation Improvement Act requires that institutions be classified, based on their risk-based capital ratios into one of five defined categories, as illustrated below: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.

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

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

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

regulatory approval. Under FDICIA, financial institutions are subject to increased regulatory scrutiny and must comply with certain operational, managerial and compensation standards developed by Federal Reserve Board regulations.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) INSURANCE ASSESSMENTS The subsidiary bank is subject to deposit insurance assessments by the FDIC. The assessments are based on the risk classification of the depository institution. The subsidiary bank was required to pay regular FDIC insurance assessments in 2009 of $1,743,000 and a special assessment on September 30, 2009, of $437,000. Furthermore, on December 31, 2009, all insured institutions were required to prepay 3.25 years of regular quarterly premiums. Each institution recorded the entire amount of its prepaid assessment as a prepaid expense (an asset). ACNB recorded its prepaid assessment in the amount of $3,596,000 as a prepaid expense included in other assets as of December 30, 2009. As of December 31, 2009, and each quarter thereafter, each institution records an expense, as a charge to earnings, for its regular quarterly assessment for the quarter and an offsetting credit to the prepaid assessment until the asset is exhausted or refunded. Once the asset is exhausted or refunded, the institution records an accrued expense payable each quarter for the assessment payment, which is paid in arrears to the FDIC at the end of the following quarter. If the prepaid assessment is not exhausted by June 30, 2013, any remaining amount will be returned to the depository institution. The FDIC also has adopted a uniform three basis point increase in assessment rates effective January 1, 2011.

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

- Raising the threshold requiring registration under the Securities Exchange Act of 1934 (Exchange Act) for banks and bank holding companies from 500 to 2,000 holders of record;
- Raising the threshold for triggering deregistration under the Exchange Act for banks and bank holding companies from 300 to 1,200 holders of record;
- Raising the limit for Regulation A offerings from $5 million to $50 million per year and exempting some Regulation A offerings from state blue sky laws;
- Permitting advertising and general solicitation in Rule 506 and Rule 144A offerings;
- Allowing private companies to use "crowd funding" to raise up to $1 million in any 12-month period, subject to certain conditions; and,
- Creating a new category of issuer, called an "Emerging Growth Company", for companies with less than $1 billion in annual gross revenue, which will benefit from certain changes that reduce the cost and burden of carrying out an equity initial public offering (IPO) and complying with public company reporting obligations for up to five years.

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

Dividends

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

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Regulation of Bank

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

ACCOUNTING POLICY DISCLOSURE

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

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

STATISTICAL DISCLOSURES

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

Interest Rate Sensitivity Analysis

Interest Income and Expense, Volume and Rate Analysis

Investment Portfolio

Loan Maturity and Interest Rate Sensitivity

Loan Portfolio

Allocation of Allowance for Loan Losses

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Deposits

Short-Term Borrowings

AVAILABLE INFORMATION

The Corporation's reports, proxy statements, and other information are available for inspection and copying at the SEC Office of Freedom of Information Act/Privacy Act Operations at 100 F Street, N.E., Washington, DC, 20549, at prescribed rates. The public may obtain information from the Office of Investor Education and Advocacy by calling the Commission at 1-800-SEC-0330. The Corporation is an electronic filer with the Commission. The Commission maintains a website that contains reports, proxy and information statements, and other information regarding registrants that file electronically with the Commission. The address of the Commission's website is http://www.sec.gov.

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

EMPLOYEES

As of December 31, 2012, ACNB had 283 full-time equivalent employees. None of these employees are represented by a collective bargaining agreement, and ACNB believes it enjoys good relations with its personnel.

ITEM 1A RISK FACTORS

ACNB IS SUBJECT TO INTEREST RATE RISK.

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

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

ACNB IS SUBJECT TO CREDIT RISK.

As of December 31, 2012, approximately 44% of ACNB's loan portfolio consisted of commercial and industrial, construction, and commercial real estate loans. These types of loans are generally

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

ACNB'S ALLOWANCE FOR LOAN LOSSES MAY BE INSUFFICIENT.

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

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

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

In attracting business and consumer deposits, its banking subsidiary faces substantial competition from other insured depository institutions such as banks, savings institutions and credit unions, as well as institutions offering uninsured investment alternatives, including money market funds. Many of ACNB's competitors enjoy advantages, including greater financial resources, wider geographic presence, more aggressive marketing campaigns, better brand recognition, more branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, and lower origination and operating costs. These competitors may offer higher interest rates than ACNB, which could decrease the deposits that it attracts or require it to increase its rates to retain existing deposits or attract new deposits. Increased deposit competition could adversely affect the subsidiary's ability to

generate the funds necessary for lending operations. As a result, it may need to seek other sources of funds that may be more expensive to obtain and could increase its cost of funds.

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

THE BASEL III CAPITAL REQUIREMENTS MAY REQUIRE US TO MAINTAIN HIGHER LEVELS OF CAPITAL, WHICH COULD REDUCE ACNB'S PROFITABILITY.

If adopted as proposed, Basel III targets higher levels of base capital, certain capital buffers and a migration toward common equity as the key source of regulatory capital. Although the new capital requirements are phased in over the next decade and may change substantially before final implementation, Basel III signals a growing effort by domestic and international bank regulatory agencies to require financial institutions, including depository institutions, to maintain higher levels of capital. The direction of the Basel III implementation activities or other regulatory viewpoints could require additional capital to support our business risk profile prior to final implementation of the Basel III standards. If ACNB and the Bank are required to maintain higher levels of capital, ACNB and the Bank may have fewer opportunities to invest capital into interest-earning assets, which could limit the profitable business operations available to ACNB and the Bank and adversely impact our financial condition and results of operations.

A BREACH OF INFORMATION SECURITY COULD NEGATIVELY AFFECT ACNB'S EARNINGS.

Increasingly, we depend upon data processing, communication and information exchange on a variety of computing platforms and networks, and over the Internet. While to date we have not been subject to cyber attacks or other cyber incidents, we cannot be certain all our systems are entirely free from vulnerability to attack, despite safeguards we have instituted. In addition, we rely on the services of a variety of vendors to meet our data processing and communication needs. Disruptions to our vendors' systems may arise from events that are wholly or partially beyond our vendors' control (including, for example, computer viruses or electrical or telecommunications outages). If information security is breached, despite the controls we and our third party vendors have instituted, information can be lost or misappropriated, resulting in financial loss or costs to us or damages to others. These costs or losses could materially exceed the amount of insurance coverage, if any, which would adversely affect our earnings. In addition, our reputation could be damaged which could result in loss of customers, greater difficulty in attracting new customers, or an adverse affect on the value of our common stock.

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

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

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

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

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

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

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

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

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

ACNB's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by ACNB can be intense, and ACNB may not be able to hire people or to retain them. The unexpected loss of services of one or more of ACNB's key personnel could have a material adverse impact on ACNB's business because the Bank would no longer have the benefit of their skills, knowledge of ACNB's market, as well as years of industry experience,

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and it would be difficult to promptly find qualified replacement personnel. ACNB currently has employment agreements, including covenants not to compete, with the following named executive officers: its President & Chief Executive Officer; Executive Vice President, Secretary & Chief Governance Officer; Executive Vice President, Treasurer & Chief Financial Officer; and, the President & Chief Executive Officer of RIG.

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

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

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

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

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

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

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

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THE SOUNDNESS OF OTHER FINANCIAL INSTITUTIONS MAY ADVERSELY AFFECT ACNB.

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

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

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

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

ACNB's regulators or market conditions may require it to increase its capital levels. If ACNB raises capital through the issuance of additional shares of its common stock or other securities, it would likely dilute the ownership interests of current investors and would likely dilute the per share book value and earnings per share of its common stock. Furthermore, it may have an adverse impact on ACNB's stock price. New investors may also have rights, preferences and privileges senior to ACNB's current shareholders, which may adversely impact its current shareholders. ACNB's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside its control, and on its financial performance. Accordingly, ACNB cannot be assured of its ability to raise additional capital on terms and time frames acceptable to it or to raise additional capital at all. If ACNB cannot raise additional capital in sufficient amounts when needed, its ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect ACNB's operations, financial condition, and results of operations.

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

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

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

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

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

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

ACNB IS SUBJECT TO POTENTIAL IMPAIRMENT OF GOODWILL AND INTANGIBLES.

RIG has certain long-lived assets including purchased intangible assets subject to amortization, such as insurance books of business, and associated goodwill assets which are reviewed for impairment 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 in which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the 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. During the quarter ended June 30, 2012, the Corporation changed its method of applying ASC Topic 350, *Intangibles Goodwill and Other*, such that the annual goodwill impairment testing date was changed from December 31 to October 1. This new testing date is preferable, because it allows the Corporation more time to accurately complete its impairment testing process, in order to incorporate the results in the annual consolidated financial statements. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The goodwill impairment analysis currently used by the Corporation is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication

of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. ACNB performs an annual evaluation to determine if there is goodwill impairment.

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

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

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

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

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

Although ACNB evaluates every loan that it makes against its underwriting criteria, ACNB may experience losses by reasons of factors beyond its control. Some of these factors include changes in

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market conditions affecting the value of real estate and unexpected problems affecting the creditworthiness of ACNB's borrowers.

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

- An analysis of the risk characteristics of various classifications of loans;
- Previous loan loss experience;
- Specific loans that would have loan loss potential;
- Delinquency trends;
- Estimated fair value of the underlying collateral;
- Current economic conditions;
- The views of ACNB's regulators;
- Reports of internal auditors;
- Reports of external auditors;
- Reports of loan reviews conducted by independent organizations; and,
- Geographic and industry loan concentration.

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

- Borrowers may not be able to repay their loans;
- The value of the collateral securing ACNB's loans to borrowers may decline; and/or,
- The quality of ACNB's loan portfolio may decline.

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

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

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

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

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

ACNB CONTINUALLY ENCOUNTERS TECHNOLOGICAL CHANGE.

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

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

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

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

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

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THE CURRENT SLOW ECONOMIC CONDITIONS MAY ADVERSELY AFFECT SECONDARY SOURCES OF LIQUIDITY.

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

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

The unpredictable nature of events such as severe weather, natural disasters, acts of war or terrorism, and other adverse external events could have a significant impact on ACNB's ability to conduct business. If any of its financial, accounting, network or other information processing systems fail or have other significant shortcomings, ACNB could be materially adversely affected. Third parties with which ACNB does business could also be sources of operational risk to ACNB, including the risk that the third parties' own network and information processing systems could fail. Any of these occurrences could materially diminish ACNB's ability to operate one or more of the Corporation's businesses, or result in potential liability to clients, reputational damage and regulatory intervention, any of which could materially adversely affect ACNB. Such events could affect the stability of ACNB's deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, impair ACNB's liquidity, cause significant property damage, and result in loss of revenue, and/or cause ACNB to incur additional expenses.

ACNB may be subject to disruptions or failures of the financial, accounting, network and information processing systems arising from events that are whole or partially beyond ACNB's control, which may include, for example, computer viruses, electrical or telecommunications outages, natural disasters, disease pandemics, damage to property or physical assets, or terrorist acts. ACNB has developed a comprehensive business continuity plan which includes plans to maintain or resume operations in the event of an emergency, such as a power outage or disease pandemic, and contingency plans in the event that operations or systems cannot be resumed or restored. The business continuity plan is updated as needed, periodically reviewed, and components are regularly tested. ACNB also reviews and evaluates the business continuity plans of critical third-party service providers. While ACNB believes its business continuity plan and efforts to evaluate the business continuity plans of critical third-party service providers help mitigate risks, disruptions or failures affecting any of these systems may cause interruptions in service to customers, damage to ACNB's reputation and loss or liability to the Corporation.

FUTURE CREDIT DOWNGRADES OF THE UNITED STATES GOVERNMENT DUE TO ISSUES RELATING TO DEBT AND THE DEFICIT MAY ADVERSELY AFFECT ACNB.

As a result of failure of the federal government to reach agreement over federal debt and the ongoing issues connected with the debt ceiling, certain rating agencies placed the United States government's long-term sovereign debt rating on their equivalent of negative watch and announced the possibility of a rating downgrade. The rating agencies, due to constraints related to the rating of the United States, also placed government-sponsored enterprises in which ACNB invests and receives lines of credit on negative watch and a downgrade of the United State's credit rating would trigger a similar downgrade in the credit rating of these government sponsored enterprises. Furthermore, the credit rating of other entities, such as state and local governments, may also be downgraded should the United States credit rating be downgraded. The impact that a credit rating downgrade may have on the

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national and local economy could have an adverse effect on ACNB's financial condition and results of operations.

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

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

INCOME TAXATION CHANGES COULD HAVE NEGATIVE EFFECTS ON RESULTS OF OPERATIONS AND ASSET VALUES.

Discussions of proposed major overhauls of the federal corporate tax code could result in unknown and unpredictable effects on ACNB's results of operations and value of assets. Proposals that would lower the corporate tax rate and, at the same time, reduce certain deductions from taxable income are aimed to increase overall revenue from corporate taxation. For example, reducing the tax deductibility of state and local government investments and loans would increase income tax expense and could perhaps decrease the value of those assets. Lowering tax rates would decrease the value of certain deferred tax assets. In addition, changes to individual income tax laws could have the effect of lowering demand for important sources of lending and revenue to ACNB, such as residential mortgages. Shorter term effects of changes in taxation, as a result of the "fiscal cliff," could be detrimental to the broad economy, thereby reducing demand for lending or increasing the likelihood of loan defaults.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

ACNB Bank, in addition to its main office in Gettysburg, Adams County, Pennsylvania, had a retail banking office network of eighteen offices at December 31, 2012. All offices are located in Adams County with the exception of one office located in Cumberland County and four offices located in York County, Pennsylvania. There are also loan production offices situated in Franklin County and York County, Pennsylvania. Offices at fifteen locations are owned, while six are leased. All real estate owned by the subsidiary bank is free and clear of encumbrances. RIG has two leased offices located in Carroll County and Montgomery County, Maryland.

ITEM 3 LEGAL PROCEEDINGS

As of December 31, 2012, there were no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which ACNB or its subsidiaries are a party or by which any of their property is the subject. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation or its subsidiaries by governmental authorities.

ITEM 4 MINE SAFETY DISCLOSURES

Not Applicable.

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PART II

ITEM 5 MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

ACNB Corporation's common stock trades on NASDAQ under the symbol ACNB. At December 31, 2012 and 2011, there were 20,000,000 shares of common stock authorized, 6,027,968 and 6,008,409 shares issued, respectively, and 5,965,368 and 5,945,809 shares outstanding, respectively. As of December 31, 2012, ACNB had approximately 2,418 stockholders of record. At December 31, 2012 and 2011, there were 62,600 shares of treasury stock purchased by the Corporation through the common stock repurchase program approved in October 2008. There have been no shares purchased during the most recent quarter and 57,400 shares can still be purchased under the program. ACNB is restricted as to the amount of dividends that it can pay to stockholders by virtue of the restrictions on the banking subsidiary's ability to pay dividends to ACNB under the Pennsylvania Banking Code, the Federal Deposit Insurance Corporation Act, and the regulations of the FDIC. For further information, please refer to Notes J and N of the consolidated financial statements.

On May 5, 2009, stockholders approved and ratified the ACNB Corporation 2009 Restricted Stock Plan, effective as of February 24, 2009, in which awards shall not exceed, in the aggregate, 200,000 shares of common stock. As of December 31, 2012, there were no shares of common stock granted as restricted stock awards to either employees or directors.

On May 5, 2009, stockholders approved and adopted the amendment to the Articles of Incorporation of ACNB Corporation to authorize up to 20,000,000 shares of preferred stock, par value $2.50 per share. As of December 31, 2012, there were no issued or outstanding shares of preferred stock.

On January 24, 2011, the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan was introduced for stockholders of record. This plan provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. As of December 31, 2012, there were 37,025 shares of common stock issued through the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan.

There have been no unregistered sales of stock in 2012, 2011 or 2010.

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

	Price Range Per Share		Per Share
	High	Low	Dividend
2012:			
First Quarter	**$ 15.00**	**$ 13.73**	**$ 0.19**
Second Quarter	**14.98**	**14.25**	**0.19**
Third Quarter	**15.99**	**14.06**	**0.19**
Fourth Quarter	**16.75**	**15.34**	**0.19**
2011:			
First Quarter	$ 16.50	$ 15.00	$ 0.19
Second Quarter	16.50	14.85	0.19
Third Quarter	15.99	13.70	0.19
Fourth Quarter	15.50	13.34	0.19

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Total Return Performance

Index	Period Ending 12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
ACNB Corporation	100.00	85.94	95.74	122.37	113.54	139.67
NASDAQ Composite	100.00	60.02	87.24	103.08	102.26	120.42
Mid-Atlantic Custom Peer Group*	100.00	78.25	74.51	82.19	82.68	95.49

* *Mid-Atlantic Custom Peer Group consists of Mid-Atlantic commercial banks with assets less than $1B as of September 30, 2012, and indicated below. Source: SNL Financial LC, Charlottesville, VA*

Company	City	State	Company	City	State
1st Colonial Bancorp, Inc.	Collingswood	NJ	Brunswick Bancorp	New Brunswick	NJ
1st Constitution Bancorp	Cranbury	NJ	Calvin B. Taylor Bankshares, Inc.	Berlin	MD
Absecon Bancorp	Absecon	NJ	Capital Bank of New Jersey	Vineland	NJ
Adirondack Trust Company	Saratoga Springs	NY	Carroll Bancorp, Inc.	Sykesville	MD
Allegheny Valley Bancorp, Inc.	Pittsburgh	PA	Carrollton Bancorp	Columbia	MD
American Bank Incorporated	Allentown	PA	CB Financial Services, Inc.	Carmichaels	PA
Annapolis Bancorp, Inc.	Annapolis	MD	CBT Financial Corporation	Clearfield	PA
Apollo Bancorp, Inc.	Apollo	PA	CCFNB Bancorp, Inc.	Bloomsburg	PA
Ballston Spa Bancorp, Inc.	Ballston Spa	NY	Cecil Bancorp, Inc.	Elkton	MD
Bancorp of New Jersey, Inc.	Fort Lee	NJ	Citizens Financial Services, Inc.	Mansfield	PA
Bank of Akron	Akron	NY	Citizens National Bank of Meyersdale	Meyersdale	PA
Bank of Utica	Utica	NY	Clarion County Community Bank	Clarion	PA
BCSB Bancorp, Inc.	Baltimore	MD	Commercial National Financial Corporation	Latrobe	PA
Berkshire Bancorp Inc.	New York	NY	Community Bank of Bergen County	Maywood	NJ
Community First Bank	Somerset	NJ	Kish Bancorp, Inc.	Reedsville	PA
Community National Bank	Great Neck	NY	Landmark Bancorp, Inc.	Pittston	PA
Community National Bank of Northwestern Pennsylvania	Albion	PA	Liberty Bell Bank	Marlton	NJ
Community Partners Bancorp	Tinton Falls	NJ	Luzerne National Bank Corporation	Luzerne	PA
Cornerstone Financial Corp.	Mount Laurel	NJ	Lyons Bancorp, Inc.	Lyons	NY
County First Bank	La Plata	MD	Manor Bank	Manor	PA

Damascus Community Bank	Damascus	MD	Mars National Bank	Mars	PA
Delhi Bank Corp.	Delhi	NY	Mauch Chunk Trust Financial Corp.	Jim Thorpe	PA
Delmar Bancorp	Salisbury	MD	Mid Penn Bancorp, Inc.	Millersburg	PA
Dimeco, Inc.	Honesdale	PA	Mifflinburg Bank & Trust Company	Mifflinburg	PA
DNB Financial Corporation	Downingtown	PA	MNB Corporation	Bangor	PA
Elmer Bancorp, Inc.	Elmer	NJ	Muncy Bank Financial, Inc.	Muncy	PA
Elmira Savings Bank	Elmira	NY	National Bank of Coxsackie	Coxsackie	NY

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Company	City	State	Company	City	State
Embassy Bancorp, Inc.	Bethlehem	PA	National Capital Bank of Washington	Washington	DC
Emclaire Financial Corp.	Emlenton	PA	Neffs Bancorp, Inc.	Neffs	PA
Empire National Bank	Islandia	NY	New Jersey Community Bank	Freehold	NJ
ENB Financial Corp	Ephrata	PA	New Millennium Bank	New Brunswick	NJ
Enterprise National Bank N.J.	Kenilworth	NJ	New Tripoli Bancorp, Inc.	New Tripoli	PA
ES Bancshares, Inc.	Newburgh	NY	Northumberland Bancorp	Northumberland	PA
Evans Bancorp, Inc.	Hamburg	NY	Norwood Financial Corp.	Honesdale	PA
Farmers and Merchants Bank	Upperco	MD	Old Line Bancshares, Inc.	Bowie	MD
Fidelity D & D Bancorp, Inc.	Dunmore	PA	Orange County Bancorp, Inc.	Middletown	NY
First Bank	Hamilton	NJ	Parke Bancorp, Inc.	Sewell	NJ
First Community Financial Corporation	Mifflintown	PA	Pascack Bancorp, Inc.	Waldwick	NJ
First Keystone Corporation	Berwick	PA	Patapsco Bancorp, Inc.	Dundalk	MD
First National Bank of Groton	Groton	NY	Penns Woods Bancorp, Inc.	Williamsport	PA
First Resource Bank	Exton	PA	Penseco Financial Services Corporation	Scranton	PA
Fleetwood Bank Corporation	Fleetwood	PA	Peoples Financial Services Corp.	Hallstead	PA
FNB Bancorp, Inc.	Newtown	PA	Peoples Limited	Wyalusing	PA
FNBM Financial Corporation	Minersville	PA	Putnam County National Bank of Carmel	Carmel	NY
FNBPA Bancorp, Inc.	Port Allegany	PA	QNB Corp.	Quakertown	PA
Frederick County Bancorp, Inc.	Frederick	MD	Republic First Bancorp, Inc.	Philadelphia	PA
Glen Burnie Bancorp	Glen Burnie	MD	Royal Bancshares of Pennsylvania, Inc.	Narberth	PA
GNB Financial Services, Inc.	Gratz	PA	Rumson-Fair Haven Bank & Trust Co.	Rumson	NJ
Greater Hudson Bank, National Association	Middletown	NY	Scottdale Bank & Trust Company	Scottdale	PA
Hamlin Bank and Trust Company	Smethport	PA	Shore Community Bank	Toms River	NJ
Harford Bank	Aberdeen	MD	Solvay Bank Corporation	Solvay	NY
Harvest Community Bank	Pennsville	NJ	Somerset Hills Bancorp	Bernardsville	NJ
Highlands Bancorp, Inc.	Vernon	NJ	Somerset Trust Holding Company	Somerset	PA
Hilltop Community Bancorp, Inc.	Summit	NJ	Stewardship Financial Corporation	Midland Park	NJ
Honat Bancorp, Inc.	Honesdale	PA	Sussex Bancorp	Franklin	NJ
Hopewell Valley Community Bank	Pennington	NJ	Tri-County Financial Corporation	Waldorf	MD
Howard Bancorp, Inc.	Ellicott City	MD	Turbotville National Bancorp, Inc.	Turbotville	PA
IBW Financial Corporation	Washington	DC	UNB Corporation	Mount Carmel	PA
Jeffersonville Bancorp	Jeffersonville	NY	Unity Bancorp, Inc.	Clinton	NJ
Jonestown Bank and Trust Co.	Jonestown	PA	VSB Bancorp, Inc.	Staten Island	NY
JTNB Bancorp, Inc.	Jim Thorpe	PA	West Milton Bancorp, Inc.	West Milton	PA
Juniata Valley Financial Corp.	Mifflintown	PA	Woodlands Financial Service Company	Williamsport	PA
Kinderhook Bank Corporation	Kinderhook	NY			

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ITEM 6 SELECTED FINANCIAL DATA

Dollars in thousands, except per share data	For the Year Ended December 31, 2012	2011	2010	2009	2008
INCOME STATEMENT DATA					
Interest income	**$ 40,439**	$ 41,832	$ 44,640	$ 45,812	$ 47,921
Interest expense	**6,095**	7,462	9,623	13,560	18,897
Net interest income	**34,344**	34,370	35,017	32,252	29,024
Provision for loan losses	**4,675**	5,435	6,410	4,750	5,570
Net interest income after provision for loan losses	**29,669**	28,935	28,607	27,502	23,454
Other income	**11,867**	11,737	12,172	11,703	10,438
Other expenses	**30,331**	30,016	30,303	30,629	26,071
Income before income taxes	**11,205**	10,656	10,476	8,576	7,821
Applicable income taxes	**2,319**	2,154	2,057	1,357	1,077
Net income	**$ 8,886**	$ 8,502	$ 8,419	$ 7,219	$ 6,744
BALANCE SHEET DATA (AT YEAR-END)					
Assets	**$ 1,049,995**	$ 1,004,823	$ 968,667	$ 961,904	$ 976,679
Securities	**215,949**	219,259	200,774	219,929	252,536
Loans, net	**691,311**	678,986	650,039	632,706	630,330
Deposits	**834,176**	782,795	746,526	728,523	690,297
Borrowings	**107,257**	117,153	120,585	135,585	190,404
Stockholders' equity	**101,264**	97,474	93,754	88,303	84,439
COMMON SHARE DATA					
Earnings per share basic	**$ 1.49**	$ 1.43	$ 1.42	$ 1.22	$ 1.13
Cash dividends paid	**0.76**	0.76	0.76	0.76	0.76
Book value per share	**16.98**	16.39	15.81	14.90	14.18
Weighted average number of common shares	**5,953,723**	5,936,030	5,928,343	5,936,001	5,988,525
Dividend payout ratio	**50.91%**	53.15%	53.52%	62.50%	67.47%
PROFITABILITY RATIOS AND CONDITION					
Return on average assets	**0.86%**	0.85%	0.86%	0.75%	0.72%
Return on average equity	**8.91%**	8.80%	9.15%	8.34%	7.96%
Average stockholders' equity to average assets	**9.61%**	9.72%	9.40%	8.99%	9.10%
SELECTED ASSET QUALITY RATIOS					
Non-performing loans to total loans	**1.00%**	2.02%	2.35%	2.39%	1.52%
Net charge-offs to average loans outstanding	**0.48%**	0.77%	0.47%	0.03%	0.68%
Allowance for loan losses to total loans	**2.38%**	2.23%	2.29%	1.86%	1.16%
Allowance for loan losses to non-performing loans	**237.04%**	110.29%	97.43%	77.72%	76.33%

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

INTRODUCTION

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

CRITICAL ACCOUNTING POLICIES

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

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

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

Accounting Standards Codification (ASC) Topic 350, *Intangibles Goodwill and Other,* requires that goodwill is not amortized to expense, but rather that it be 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, 2012. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur. During the quarter ended June 30, 2012, the Corporation changed its method of applying ASC Topic 350 such that the annual goodwill impairment testing date was changed from December 31 to October 1. This new testing date is preferable under the circumstances, because it allows the Corporation more time to accurately complete its impairment testing process in order to incorporate the results in the annual consolidated financial statements. 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.

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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.

EXECUTIVE OVERVIEW

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

The Corporation's overall strategy is to increase loan growth in local markets, while maintaining a reasonable funding base by offering competitive deposit products and services. The year 2012 continued to be challenging for many financial institutions with continued high levels of problem assets, slowly recovering housing markets, lingering high unemployment, and slow uneven growth. ACNB continued to be profitable and well capitalized despite expenses elevated from the aftershocks of this unprecedented challenge to the United States economy. Lower provision for loan losses, which is still quite high by historic levels, and continued careful expense control resulted in increased net income to $8,886,000, or $1.49 per share, in 2012, compared to $8,502,000, or $1.43 per share, in 2011 and $8,419,000, or $1.42 per share, in 2010. Returns on average equity were 8.91%, 8.80% and 9.15% in 2012, 2011 and 2010, respectively.

Because funding costs were near practical floors, they could not be decreased at the same rate of earning assets decreases, therefore the Corporation's net interest margin decreased to 3.56% in 2012, compared to 3.74% and 3.92% in 2011 and 2010, respectively. Net interest income was $34,344,000 in 2012, as compared to $34,370,000 in 2011 and $35,017,000 in 2010.

Other income was $11,867,000, $11,737,000 and $12,172,000 in 2012, 2011 and 2010, respectively. The largest source of other income is commissions from insurance sales from Russell Insurance Group, Inc. (RIG), which increased by 0.2% in 2012 to $4,835,000, slowed by the effects of lower premium insurance and reduced commercial insurance volume due to economic contractions. In 2012, a $7,000 net gain was recognized on called investments compared to net gains of $1,000 in 2011 and $72,000 in 2010. Income from fiduciary activities totaled $1,224,000 for 2012, as compared to $1,396,000 for 2011 and $1,303,000 for 2010. Trust fiduciary income decreased from lost accounts under administration and lower estate settlement fees. Service charges on deposit accounts increased less than 1% to $2,433,000 for 2012, and revenue from ATM and debit card transactions increased 4% to $1,291,000 due to higher volume.

Other expenses increased to $30,331,000, or by 1%, in 2012, as compared to $30,016,000 in 2011. Other expenses totaled $30,303,000 in 2010. The largest component of other expenses is salaries and employee benefits, which increased 8% to $18,553,000 in 2012 compared to $17,138,000 in 2011, due to higher employee retirement expenses, merit increases, and increased cost of benefits. Compared to 2011, occupancy expense decreased 4% in 2012 due to less specific repairs, and equipment expense decreased 3% from fewer equipment purchases in 2012. Professional services expenses decreased 9% due to less problem loan-related legal expense in 2012. Marketing and corporate relations expense decreased by 22% due to the use of more internal production resources. FDIC and regulatory expenses

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decreased by 18%, still a significantly higher expense since 2009 as the result of a requirement of all FDIC-insured banks to restore the Deposit Insurance Fund due to the cost of protecting depositors' accounts at failed banks during the severe recession. In 2012, foreclosed real estate expenses benefited from recoveries of previous charge-offs and charge-downs. A more thorough discussion of the Corporation's results of operations is included in the following pages.

RESULTS OF OPERATIONS

Net Interest Income

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

Net interest income is affected by changes in interest rates, volume of interest bearing assets and liabilities, and the composition of those assets and liabilities. The "interest rate spread" and "net interest margin" are two common statistics related to changes in net interest income. The interest rate spread represents the difference between the yields earned on interest earning assets and the rates paid for interest bearing liabilities. The net interest margin is defined as the percentage of net interest income to average earning assets, which also considers the Corporation's net non-interest bearing funding sources, the largest of which are non-interest bearing demand deposits and stockholders' equity.

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

Table 1 Average Balances, Rates and Interest Income and Expense

	2012			2011			2010		
Dollars in thousands	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
INTEREST EARNING ASSETS									
Loans	**$ 701,243**	**$ 33,990**	**4.85%**	$ 674,897	$ 34,493	5.11%	$ 663,642	$ 36,043	5.43%
Taxable securities	**178,783**	**4,876**	**2.73%**	184,642	6,006	3.25%	176,758	7,181	4.06%
Tax-exempt securities	**45,952**	**1,457**	**3.17%**	33,681	1,252	3.72%	34,470	1,308	3.79%
Total Securities	**224,735**	**6,333**	**2.82%**	218,323	7,258	3.32%	211,228	8,489	4.02%
Other	**37,907**	**116**	**0.31%**	26,826	81	0.30%	17,902	108	0.60%
Total Interest Earning Assets	**963,885**	**40,439**	**4.20%**	920,046	41,832	4.55%	892,772	44,640	5.00%
Cash and due from banks	**13,197**			13,556			14,721		
Premises and equipment	**14,302**			13,898			14,324		
Other assets	**62,345**			62,301			71,180		
Allowance for loan losses	**(15,761)**			(15,369)			(14,068)		
Total Assets	**$ 1,037,968**			$ 994,432			$ 978,929		
LIABILITIES AND STOCKHOLDERS' EQUITY									
INTEREST BEARING LIABILITIES									
Interest bearing demand deposits	**$ 165,569**	**$ 139**	**0.08%**	$ 138,242	$ 115	0.08%	$ 128,835	$ 125	0.10%
Savings deposits	**243,050**	**280**	**0.12%**	230,221	354	0.15%	214,812	445	0.21%
Time deposits	**282,568**	**3,022**	**1.07%**	292,381	3,988	1.36%	304,891	5,653	1.85%
Total Interest Bearing Deposits	**691,187**	**3,441**	**0.50%**	660,844	4,457	0.67%	648,538	6,223	0.96%
Short-term borrowings	**48,300**	**76**	**0.16%**	43,124	91	0.21%	42,849	119	0.28%
Long-term borrowings	**74,942**	**2,578**	**3.44%**	76,776	2,914	3.80%	85,385	3,281	3.84%
Total Interest Bearing Liabilities	**814,429**	**6,095**	**0.75%**	780,744	7,462	0.96%	776,772	9,623	1.24%
Non-interest bearing demand deposits	**116,507**			109,070			98,862		
Other liabilities	**7,255**			8,005			11,321		
Stockholders' equity	**99,777**			96,613			91,974		
Total Liabilities and Stockholders' Equity	**$ 1,037,968**			$ 994,432			$ 978,929		
NET INTEREST INCOME		**$ 34,344**			$ 34,370			$ 35,017	
INTEREST RATE SPREAD			**3.45%**			3.59%			3.76%
NET INTEREST MARGIN			**3.56%**			3.74%			3.92%

For yield calculation purposes, nonaccruing loans are included in average loan balances. Loan fees of $6,000, $48,000 and $52,000 as of December 31, 2012, 2011 and 2010, respectively, are included in interest income. Yields on tax-exempt securities are not tax effected.

Table 1 presents balance sheet items on a daily average basis, net interest income, interest rate spread, and net interest margin for the years ending December 31, 2012, 2011 and 2010. Table 2 analyzes the relative impact on net interest income for changes in the volume of interest

earning assets and interest bearing liabilities and changes in rates earned and paid by the Corporation on such assets and liabilities.

Net interest income totaled $34,344,000 in 2012, as compared to $34,370,000 in 2011 and $35,017,000 in 2010. During 2012, net interest income decreased as a result of lower interest income

exceeding lower funding cost due to the inability to lower deposit rates further after several years of continued record low rates. The decrease in net interest income in 2011 was also due to declines in earning assets exceeding the ability to decrease low deposit rates, as well as a non-recurring interest recovery recognized in 2010.

The net interest margin during 2012 was 3.56% compared to 3.74% during 2011. The margin decreased due to continued decreasing earning asset yields that exceeded decreasing funding costs from lower rates on new or renewed time deposits and lower market rates on savings products. The Federal Open Market Committee repeatedly decreased the federal funds rate from September 2007 to December 2008 and has maintained it at 0% to 0.25% since that time. In addition, the Federal Reserve Bank has embarked on various programs referred to as Quantitative Easing which, in effect, attempted to lower rates on longer term portions of the yield curve. These decreases allowed interest rate reductions on lower-cost transactional deposit products and higher-cost certificates of deposit; the result was a 0.21% decrease in funding costs in 2012. Overtaking the benefit of a lower cost of funds in 2012, however, was earning asset yield decreasing 0.35% from declines in the investment portfolio as new purchases were at lower rates, as well as declines in the loan portfolio from new originations at lower market rates and existing adjustable-rate loans resetting at lower rates based on declines in index rates. The decreased earning asset yields in 2011 were in addition to additional interest earned in 2010 of $605,000 on the full payoff of a loan that was in nonaccrual status in prior years. This one-time recovery increased earning asset yield and net interest margin by seven basis points (.07%) for the year ended December 31, 2010. Maintaining the net interest margin going forward will be challenged by the fact that substantial amounts of deposits are at practical rate floors, while loans and the investment securities portfolio will most likely continue to decrease in yields. The cost and availability of wholesale funding could also be affected by a variety of internal and external factors resulting from interest rate market factors and the creditworthiness of the Corporation and the credit providers.

Average earning assets were $963,885,000 in 2012, an increase of 5% from the balance of $920,046,000 in 2011, which was an increase from $892,772,000 in 2010. Loan growth represented the largest increase in average assets in 2012 and 2011, along with smaller increases in the investment portfolio and interest bearing deposits in those years. Loan growth in 2010 was partially offset by decreases in the investment portfolio. Average interest bearing liabilities were $814,429,000 in 2012, up from $780,774,000 in 2011 and from $776,772,000 in 2010. Average non-interest bearing demand deposits increased 7% in 2012, continuing the trend upward for 2011 and 2010. This increase was attributed to new relationships and the value placed on stability and FDIC insurance by depositors. On average, deposits (including non-interest bearing) were up 5%, while borrowings increased by 3% due to increases in local commercial repurchase accounts, which are similar to interest bearing deposits. Lower-cost transaction and savings deposits grew while time deposits decreased in 2012, continuing a trend started in 2008. This trend is attributed to depositors favoring liquidity in a generally low rate environment.

The rate/volume analysis detailed in Table 2 shows that the decrease in net interest income in 2012 was due to earning asset rate decreases exceeding funding cost rate decreases. Earning asset yields declined due to new purchases at lower rates in the investment portfolio and declines in the loan portfolio from existing adjustable rate loans resetting at lower rates and new lower-rate originations replacing loan amortizations at higher rates. In 2012, the decrease in interest income was 2% higher than the decrease in interest expense. Interest expense decreased due to less time deposit and borrowed fund volume and rate decreases in all interest bearing liability categories.

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

Table 2 Rate/Volume Analysis

	2012 versus 2011			2011 versus 2010		
	Due to Changes in			Due to Changes in		
In thousands	**Volume**	**Rate**	**Total**	**Volume**	**Rate**	**Total**
INTEREST EARNING ASSETS						
Loans	**$ 1,317**	**$ (1,820)**	**$ (503)**	$ 603	$ (2,153)	$ (1,550)
Taxable securities	**(186)**	**(944)**	**(1,130)**	309	(1,484)	(1,175)
Tax-exempt securities	**408**	**(203)**	**205**	(30)	(26)	(56)
Total Securities	**222**	**(1,147)**	**(925)**	279	(1,510)	(1,231)
Other	**34**	**1**	**35**	40	(67)	(27)
Total	**$ 1,573**	**$ (2,966)**	**$ (1,393)**	$ 922	$ (3,730)	$ (2,808)
INTEREST BEARING LIABILITIES						
Interest bearing demand deposits	**$ 23**	**$ 1**	**$ 24**	$ 9	$ (19)	$ (10)
Savings deposits	**19**	**(93)**	**(74)**	30	(121)	(91)
Time deposits	**(130)**	**(836)**	**(966)**	(224)	(1,441)	(1,665)
Short-term borrowings	**10**	**(25)**	**(15)**	1	(29)	(28)
Long-term borrowings	**(68)**	**(268)**	**(336)**	(327)	(40)	(367)
Total	**(146)**	**(1,221)**	**(1,367)**	(511)	(1,650)	(2,161)
Change in Net Interest Income	**$ 1,719**	**$ (1,745)**	**$ (26)**	$ 1,433	$ (2,080)	$ (647)

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

Provision for Loan Losses

The provision for loan losses charged against earnings was $4,675,000 in 2012, as compared to $5,435,000 in 2011 and $6,410,000 in 2010. ACNB adjusts the provision for loan losses periodically as necessary to reflect current conditions in the loan portfolio and to maintain the allowance at a level deemed to meet the risk characteristics of the loan portfolio.

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

Other Income

Other income was $11,867,000 for the year ended December 31, 2012, a $130,000, or 1%, increase from 2011. The largest source of other income is commissions from insurance sales from RIG, which increased less than 1% to $4,835,000. The increase was despite lost customers in the economic downturn and a soft (low premium) market and was due in part to concentrating on maintaining stable sectors. "Contingent" commissions were consistent year over year; the "contingent" or extra commission payments from insurance carriers are mostly received in the first quarter of each year, and the amount is at the discretion of various insurance carriers in accordance with applicable insurance regulations. Heightened pressure on commissions is expected to continue in this business line and contingent commissions are not predictable.

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In 2012, investment gains on called securities of $7,000 were recognized compared to similar type gains of $1,000 in 2011, compared with $72,000 gains of sales in 2010. The higher gains in 2010 were to adjust the interest rate and credit risk composition of the portfolio by selling selected municipal securities; no sales were made in 2012 or 2011.

Income from fiduciary activities, which includes fees from both institutional and personal trust and asset management services and estate settlement services, totaled $1,224,000 for the year ended December 31, 2012, as compared to $1,396,000 for 2011 and $1,303,000 for 2010. At December 31, 2012, ACNB had total assets under administration of approximately $141,000,000, compared to $135,000,000 at the end of 2011 and $152,000,000 at the end of 2010. The variations in income were in part the result of higher estate settlement income in 2011 which varies with specific activity.

Service charges on deposit accounts increased less than 1% to $2,433,000 on varying customer actions. Further, certain government regulations and policies effective since 2010 limited service charge increases and make future revenue levels uncertain. Revenue from ATM and debit card transactions increased 4% to $1,291,000 due to higher volume. The 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 in future periods, the effect of which cannot be currently quantified. Fee income from sold mortgages increased by $38,000, or 15%, due to higher sold mortgage volume.

Impairment Testing

RIG has certain long-lived assets, including purchased intangible assets subject to amortization such as insurance books of business, and associated goodwill assets, which are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the 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 each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill

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impairment losses is not permitted. As noted above, commissions from insurance sales were up in 2012, although RIG's stand alone net income decreased in 2012 compared to 2011 because of startup costs of a new business line and earned incentive payments. The testing for potential impairment involves 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.

The results of the annual evaluations determined that there was no impairment of goodwill, including the testing at October 1, 2012. However, future declines in RIG's net income or changes in external market factors, including likely buyers that are assumed in impairment testing, may require an impairment charge to goodwill. A liability incurred at December 31, 2011, for contingent consideration owed on previous purchases of additional insurance books of business, did not unfavorably impact the fair value of RIG. The liability for further contingent consideration incurred was $338,000 compared to a maximum aggregate liability of $1,800,000 on two purchases that had a contingent consideration measurement date at December 31, 2011. The actual liability was lower than the potential maximum aggregate liability due to the uncertainties in retaining books of business in the current economic cycle. Should it be determined in a future period that the goodwill has been impaired, then a charge to earnings will be recorded in the period that such a determination is made.

During the quarter ended June 30, 2012, the Corporation changed its method of applying ASC Topic 350 such that the annual goodwill impairment testing date was changed from December 31 to October 1. This new testing date is preferable in the circumstances, because it allows the Corporation more time to accurately complete its impairment testing process, in order to incorporate the results in the annual consolidated financial statements.

Other Expenses

Other expenses increased 1% to $30,331,000 for the year ended December 31, 2012. The largest component of other expenses is salaries and employee benefits, which increased 8% to $18,553,000 compared to $17,138,000 in 2011. The reasons for the increase in salaries and employee benefits expenses include the following:

- increased defined benefit pension expense due to prior year plan investment performance and continued historic low discount rates that increase the liabilities for future obligations;
- higher benefit plan costs, including medical insurance;
- higher production-based commissions and incentives;
- increases from 401(k) plan benefits and other non qualified retirement plans; and,
- normal merit increases to employees and payroll taxes.

Salaries and employee benefits decreased $180,000 or 1% from 2010 to 2011. The decreased expense was due primarily to a significantly lower defined benefit pension expense in 2011 from a better return on plan assets in 2010.

The Corporation reduced the benefit formula for the defined benefit pension plan effective January 1, 2010, in order to manage total benefit costs. Subsequently, 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 Corporation's overall investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation's risk tolerance on contribution levels, funded status, Plan expense, as well as any applicable regulatory requirements. However, the determination of future benefit expense is also

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dependent on the fair value of assets and the discount rate on the year-end measurement date; which in recent years has experienced low discount rates and fair value volatility. The expense will be stable in 2013 despite the historically low rates at the latest measurement date due to better Plan return in 2012. A pension provision in a public law known as MAP-21, enacted in July 2012, had no effect on reducing the GAAP expense associated with the Plan. The ACNB Plan has maintained a well-funded status.

Net occupancy expense was $1,952,000 in 2012, $2,043,000 in 2011, and $2,197,000 in 2010. Equipment expense totaled $2,537,000 during 2012, as compared to $2,620,000 during 2011 and $2,499,000 during 2010. Occupancy was lower in 2012 due to a mild winter and better preventative maintenance; equipment expenses decreased in 2012 due to less small ticket purchases that are expensed. Even with the decrease in 2012, equipment expenses are subject to ever increasing technology demands and the need for systems upgrades and reliability in a digital age. The majority of the expense increase in 2011 from 2010 was a result of various technology upgrades.

Professional services expense totaled $825,000 for 2012, as compared to $911,000 for 2011 and $1,116,000 for 2010. Increased expense in prior years included more legal expense associated with problem loans and a series of strategic initiatives that included converting the subsidiary Bank to a state charter, listing ACNB Corporation on The NASDAQ Stock Market, and work on the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan. Other tax expenses increased 4% in 2012 compared to 2011 due to an increased capital base at the Bank. Supplies and postage expenses decreased in 2012 compared to the two prior years due to customers' increased use of electronic transaction channels.

Marketing expenses decreased 22% during 2012 due to more use of internal production resources and higher expenses in 2011 related to a new retail banking office. In 2011, marketing expenses were 4% higher than in 2010 due to promoting the new office.

FDIC and regulatory expense for 2012 was $843,000, a decrease of $183,000 from $1,026,000 in 2011. FDIC and regulatory expense in 2010 was $1,434,000. Part of the decrease was due to the subsidiary Bank's conversion to a state charter which resulted in continued rigorous state and federal examination processes, but at a lower cost. Despite the decrease in 2011 and 2010, FDIC expense for all years presented was much higher than periods before the severe financial crisis. The much higher expense was required of all FDIC-insured banks to restore the deposit insurance fund due to the cost of protecting depositors' accounts at failed banks during this recession. At the end of the third quarter of 2009, the FDIC announced a plan in which most banks prepaid 3.25 years of regular quarterly premiums at year-end 2009, as opposed to a special assessment similar to which was levied in the second quarter of 2009. The prepaid assessment did not immediately affect Bank earnings. Each institution recorded its prepaid assessment as a prepaid expense (an asset) as of December 30, 2009, the date the payment was made. At December 31, 2009, and each quarter thereafter, each institution records an expense for its regular quarterly assessment and an offsetting credit to the prepaid expense until the asset is exhausted or refunded. Once the asset is exhausted or refunded, the institution will record an accrued expense payable each quarter for the assessment payment, which is paid in arrears to the FDIC at the end of the following quarter. If the prepaid assessment is not exhausted by June 30, 2013, any remaining amount will be returned to the depository institution. The FDIC also has adopted a uniform three basis point increase in assessment rates effective January 1, 2011.

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Foreclosed assets held for resale consist of the fair value of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. Foreclosed real estate expenses were $(119,000), $725,000 and $292,000 for years ended December 31, 2012, 2011 and 2010, respectively. The net recovery in 2012 was on two properties that sold for more than their previously written down values. Some properties suffered decreases in value after acquisition (requiring write-downs to fair value) during prolonged marketing cycles for these distressed properties. Values are written down based off of updated appraisals less selling costs (which in the often extended marketing periods can create multiple year expenses) and other fair value adjustments, or in some cases properties are written down based on sales agreements that do not subsequently close. Otherwise, the historically high costs consisted of these write downs and other costs to carry and was due to the increased number and varying mix of commercial and residential collateral; and such carrying costs include insurance, property maintenance, unpaid and ongoing property taxes and deferred maintenance required upon acquisition.

Other operating expenses increased 9% in 2012 as a result of upgrades in electronic delivery and data channels, expenses from the Bank's legal responsibility to reimburse customers in electronic transactions disputes (in most cases where another party is at fault), and corporate governance expenditures. Other operating expenses increased 5% in 2011 from 2010 mainly as a result of corporate governance, communications and loan promotion expenditures.

Provision for Income Taxes

ACNB recognized income taxes of $2,319,000, or 20.7% of pretax income, during 2012, as compared to $2,154,000, or 20.2%, during 2011 and $2,057,000, or 19.6%, during 2010. The variances from the federal statutory rate are generally due to tax-exempt income (from investments in and loans to state and local units of government at below-market rates, an indirect form of taxation) and investments in low-income housing partnerships (which qualify for federal tax credits).

The increasing effective tax rate during 2012 and 2011 compared to 2010 was a result of increasing pretax income in relationship to stable tax-exempt income. Pretax income increased in 2012 and 2011 due to revenue and expense elements described above.

At December 31, 2012, net deferred tax assets amounted to $1,786,000. Deferred tax assets are realizable primarily through future reversal of existing taxable temporary differences. Management currently anticipates future earnings and capital gains will be adequate to utilize deferred tax assets. Accordingly, no valuation allowance has been established for deferred tax assets at December 31, 2012.

FINANCIAL CONDITION

Average earning assets increased in 2012 to $963,885,000, or by 5%, from $920,046,000 in 2011 following $892,772,000 in 2010. ACNB's investment portfolio increased in 2012 on average, however more funds were allocated into liquid and relatively higher paying short term investment of Federal Reserve Bank balances which was more appropriate for the mix of deposit growth. Investments had increased in 2011 from deposit growth and decreased in 2010 as a result of the planned objective to fund in-market loans and reduce average borrowings. Loans increased 4% and 2% on average in 2012 and 2011, respectively. Growth in loans was funded by increased customer deposits. Average deposits increased in 2012 to $807,694,000 from $769,914,000 in 2011 and $747,400,000 in 2010. Average borrowings increased in 2012 to $123,242,000 from $119,900,000 in 2011 and were $128,234,000 in 2010. Fluctuations in borrowings are mainly in local customer repurchase accounts, akin to deposits.

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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 decrease in the securities portfolio in 2012 was mainly to deploy growth in deposits into a more suitable allocation to Federal Reserve balances that combined the desired combination of yield, liquidity and manageable interest rate risk sensitivity. Investing into investment security portfolio assets was made more challenging due to the Federal Reserve Bank's program commonly called Quantitative Easing in which, by their open market purchases, the yields are maintained at a lower level than would otherwise be the case. The increase in the securities portfolio during 2011 was the preferred asset allocation for deposit growth in that year. The investment portfolio is comprised of U.S. Government agency, municipal, and corporate securities. These securities provide the appropriate characteristics with respect to credit quality, yield and maturity relative to the management of the overall balance sheet.

At December 31, 2012, the securities balance included a net unrealized gain on available for sale securities of $5,614,000, net of taxes, on amortized cost of $157,288,000 versus a net unrealized gain of $5,996,000, net of taxes, on amortized cost of $200,144,000 at December 31, 2011. The decrease in fair value of available for sale securities during 2012 was a result of a lower amount of investments in the available for sale portfolio and changes in the U.S. Treasury yield curve and the spread from this yield curve required by investors on the types of investment securities that ACNB owns. Actions by the Federal Reserve to lower rates on the yield curve most conducive to stimulating the housing market and separate concerns about European sovereign debt offset the bonds markets concern about the level of U.S. debt and inflation, leading to generally lower rates in the yield curve, however fair values were volatile on any given day in 2012. The Corporation does not own investments consisting of pools of Alt A or subprime mortgages, private label mortgage-backed securities, or trust preferred investments. The fair values of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1) or by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on securities' relationship to other benchmark quoted prices. The Corporation uses reliable service providers to provide matrix pricing. Please refer to Note C "Securities" in the Notes to Consolidated Financial Statements for more information on the security portfolio and Note L "Fair Value Measurements" in the Notes to Consolidated Financial Statements for more information about fair value.

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

Table 3 Investment Securities

In thousands	2012	2011	2010
AVAILABLE FOR SALE SECURITIES AT FAIR VALUE			
U.S. Government and agencies	**$ 24,241**	$ 40,169	$ 28,260
Mortgage-backed securities	**80,583**	107,527	114,359
State and municipal	**51,804**	46,317	34,676
Corporate bonds	**7,286**	13,379	11,659
CRA mutual fund	**1,096**	1,081	1,030
Stock in other banks	**780**	754	746
	165,790	209,227	190,730
HELD TO MATURITY SECURITIES AT AMORTIZED COST			
U.S. Government and agencies	**30,115**	10,032	10,044
Mortgage-backed securities	**20,044**		
	50,159	10,032	10,044
TOTAL	**$ 215,949**	$ 219,259	$ 200,774

Table 4 discloses investment securities at the scheduled maturity date at December 31, 2012. Many securities have call features that make their redemption possible before the stated maturity date.

Table 4 Securities Maturity Schedule

	1 Year or Less		Over 1-5 Years		Over 5-10 Years		Over 10 Years or No Maturity		Total	
Dollars in thousands	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**
U.S. Government and agencies	$	%	$ 36,339	2.96%	$ 17,001	1.64%	$	%	$ 53,340	2.54%
Mortgage-backed securities					41,408	4.09	54,452	3.35	95,860	3.67
State and municipal	300	1.00	7,527	3.60	37,710	3.35	4,031	3.96	49,568	3.42
Corporate bonds	1,001	4.38	6,007	3.04					7,008	3.23
CRA mutual fund							1,044		1,044	
Stock in other banks							627		627	
	$ 1,301	3.60%	$ 49,873	3.06%	$ 96,119	3.36%	$ 60,154	3.29%	$ 207,447	3.27%

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

Loans

Year over year, loans outstanding increased by $13,668,000, or 2.0%, in 2012, as compared to 4.4% growth experienced in 2011, both years demonstrating the determined efforts to lend to creditworthy borrowers subject to our disciplined standards despite the continued difficult economic conditions. The lower increase in 2012 was caused by $10,000,000 in local government loans paying off with proceeds from that unit issuing municipal bonds. Within the portfolio, the higher growth was centered in increased commercial purpose loans (both real estate secured and non-real estate secured) and in local market residential mortgages, in part offset by continued declines in commercial construction loans. Not including the $10,000,000 loan that paid off, the commercial purpose segments increased

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$9,900,000 or 3%, during 2012; spread among diverse categories that include farmland secured, loans to local government units, and other types of commercial lending. Residential real estate mortgage lending, which include smaller commercial purpose loans secured by the owner's home, increased by $18,200,000 or 5%, to local borrowers who preferred loan types that would not be sold into the secondary mortgage market. Of the $18,200,000 increase, $3,500,000 was residential mortgage loans secured by junior liens or home equity loans, which are also in many cases junior liens. Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market continues to be weak and property values further deteriorate. Real estate construction loans continued to decline in 2012, down $3,600,000 or 16%, as a result of the weak demand in the residential real estate market and because of stricter underwriting on this type due to the category's credit attributes.

The commercial loan increase was higher in 2011 compared to 2010 as the result of more concentrated efforts by a larger lending staff despite reduced business activity in the market area that hindered new originations, as well as management's decision to not renew certain commercial loans, primarily participation credits in conjunction with other financial institutions, due to perceived potential credit risk.

Table 5 Loan Portfolio

Loans at December 31 were as follows:

In thousands	2012	2011	2010	2009	2008
Commercial, financial and agricultural	**$ 49,004**	$ 56,145	$ 52,676	$ 45,947	$ 59,861
Real estate:					
Commercial	**243,019**	236,017	225,950	209,054	173,926
Construction	**19,154**	22,757	26,635	37,966	48,958
Residential	**381,966**	363,798	345,854	337,342	341,916
Consumer	**14,993**	15,751	14,176	14,378	13,062
Total Loans	**$ 708,136**	$ 694,468	$ 665,291	$ 644,687	$ 637,723

The repricing range of the loan portfolio at December 31, 2012 and the amounts of loans with predetermined and fixed rates are presented in the tables below:

Table 6 Loan Sensitivities

LOANS MATURING

In thousands	Less than 1 Year	1-5 Years	Over 5 Years	Total
Commercial, financial and agricultural	**$ 12,395**	**$ 27,320**	**$ 9,289**	**$ 49,004**
Real estate:				
Commercial	**106,721**	**102,774**	**33,524**	**243,019**
Construction	**6,527**	**11,656**	**971**	**19,154**
Residential	**81,276**	**76,080**	**224,610**	**381,966**
Total	**$ 206,919**	**$ 217,830**	**$ 268,394**	**$ 693,143**

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LOANS BY REPRICING OPPORTUNITY

In thousands	Less than 1 Year	1-5 Years	Over 5 Years	Total
Commercial, financial and agricultural	$ 7,586	$ 22,278	$ 19,140	$ 49,004
Real estate:				
Commercial	30,022	97,558	115,439	243,019
Construction	4,975	10,739	3,440	19,154
Residential	53,056	86,251	242,659	381,966
Total	$ 95,639	$ 216,826	$ 380,678	$ 693,143
Loans with a fixed interest rate	$ 25,680	$ 42,507	$ 253,622	$ 321,809
Loans with a variable interest rate	69,959	174,319	127,056	371,334
Total	$ 95,639	$ 216,826	$ 380,678	$ 693,143

Most of the Corporation's lending activities are with customers located within the southcentral Pennsylvania and in the northern Maryland area that is contiguous to its Pennsylvania retail banking offices. This region currently and historically has lower unemployment than the U.S. as a whole. Included in commercial real estate loans are loans made to lessors of non-residential dwellings that total $100,100,000, or 14% of total loans, at December 31, 2012. These borrowers are geographically dispersed throughout ACNB's marketplace and are leasing commercial properties to a varied group of tenants including medical offices, retail space, and recreational facilities. Because of the varied nature of the tenants, in aggregate, management believes that these loans do not present any greater risk than commercial loans in general. ACNB does not originate or hold subprime mortgages in its loan portfolio.

Asset Quality

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

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

Although materially elevated from several years back, the unemployment rate in ACNB's market area remained below the state and national average during 2012. Additionally, low interest rates, a less volatile local economy, and minimal inflation continued to provide some support to the economic conditions in the area. During 2012, continued contraction in new residential real estate development/construction and general lower economic activity lingered from the recent major recession, challenging the Corporation's marketplace commercial activity. Slower growth areas such as ACNB's marketplace generally do not retract in economic recessions as quickly and as low as other areas of the country, however the recovery from low economic cycles are also generally slower.

Non-performing assets include nonaccrual loans and restructured loans (troubled debt restructures or TDRs), accruing loans past due 90 days or more, and other foreclosed assets. The accrual of interest on residential mortgage and commercial loans (consisting of commercial and industrial, commercial real estate, and commercial real estate construction loan classes) is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in the process of collection. Consumer loans (consisting of home equity lines of credit and consumer loan classes) are typically charged off no later

than 120 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful. ACNB occasionally returns nonaccrual loans to performing status when the borrower brings the loan current and performs in accordance with contractual terms for a reasonable period of time. ACNB categorizes a loan as a TDR if it changes the terms of the loan, such as interest rate, repayment schedule or both, to terms that it otherwise would not have granted to a borrower, for economic or legal reasons related to the borrower's financial difficulties.

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

Table 7 Non-Performing Assets

Dollars in thousands	2012	2011	2010	2009	2008
Nonaccrual loans, including TDRs	**$ 6,327**	$ 12,846	$ 14,657	$ 13,308	$ 7,723
Accruing loans 90 days past due	**771**	1,191	997	2,107	1,963
Total Non-Performing Loans	**7,098**	14,037	15,654	15,415	9,686
Foreclosed assets	**4,247**	4,437	7,859	6,046	625
Total Non-Performing Assets	**$ 11,345**	$ 18,474	$ 23,513	$ 21,461	$ 10,311
Total Accruing Troubled Debt Restructurings	**$ 4,815**	$	$	$	$
Ratios:					
Non-performing loans to total loans	**1.00%**	2.02%	2.35%	2.39%	1.52%
Non-performing assets to total assets	**1.08%**	1.84%	2.43%	2.23%	1.06%
Allowance for loan losses to non-performing loans	**237.04%**	110.29%	97.43%	77.72%	76.33%

If interest due on all nonaccrual loans had been accrued at original contract rates, it is estimated that income before income taxes would have been greater by $543,000 in 2012, $652,000 in 2011, and $464,000 in 2010. The decrease in nonaccrual loans is discussed further below.

Impaired loans at December 31, 2012 and 2011, totaled $11,142,000 and $12,846,000, respectively. At December 31, 2012 and 2011, $ 1,900,000 and $1,496,000, respectively, of the impaired loans were troubled debt restructured loans, which were also classified as nonaccrual. $4,815,000 of the impaired loans were accruing troubled debt restructured loans. Loans whose terms are modified are classified as troubled debt restructurings if the borrowers have been granted concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve interest rates being granted below current market rates for the credit risk of the loan or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired. The related allowance for loan losses on impaired loans totaled $36,000 and $1,181,000, respectively. The decrease in impaired loans was mainly related to loan amounts that were charged off, were repaid by the borrowers, or were eliminated by the Corporation taking legal actions to repossess the collateral and then book the fair value of the collateral, less the cost to sell, as foreclosed assets held for resale. Potential problem loans are defined as performing loans that have characteristics that cause management to have doubts as to the ability of the borrower to perform under present loan repayment terms and which may result in the reporting of these loans as non-performing loans in the future. Total additional potential problem loans approximated $13,076,000 at December 31, 2012, compared to $10,807,000 at December 31, 2011.

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 such real estate in lieu of

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the foreclosure process. Fair values are based on appraisals that consider the sale prices of similar properties in the proximate vicinity less estimated selling costs. Foreclosed assets held for resale totaled $4,247,000 at December 31, 2012, and included land associated with a local economic development project loan with a recorded fair value of $837,000. Nine other unrelated commercial use or construction real estate properties were brought into foreclosed real estate in 2010, 2011 or 2012 with an aggregate fair value of $2,876,000. In addition, the fair value of $534,000 for foreclosed real estate at December 31, 2012, represented five residential real estate single homes, one of which were taken into foreclosed real estate in 2010, the remainder in 2012. All properties are being actively marketed to targeted buyers by external and internal resources. The total of $4,437,000 at December 31, 2011, represented the economic development project, five commercial real estate, and 11 single home loans.

Allowance for Loan Losses

ACNB maintains the allowance for loan losses at a level believed to be 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 collectibility of principal and interest, it evaluates a specific reserve on a quarterly basis in order to estimate potential losses. Management's analysis considers:

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

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

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

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

- risk of imprecision in the specific and general reserve allocations;
- the perceived level of consumer and small business loans with demonstrated weaknesses for which it is not practicable to develop specific allocations;
- other potential exposure in the loan portfolio;
- variances in management's assessment of national and local economic conditions; and,
- other internal or external factors that management believes appropriate at that time.

The unallocated portion of the allowance is deemed to be appropriate as it reflects an uncertainty that remains in the loan portfolio and a Corporation specific and industry-wide hesitancy to prematurely release reserves at this time as the Corporation feels that additional losses are probable. The Corporation has determined that the amount of provision in 2012 and the resulting allowance at December 31, 2012 are appropriate given the continuing level of risk in the loan portfolio. Management believes the unallocated allowance is appropriate as the total amount of impaired loans, although down from 2011, are still elevated; low risk government loans totaling $10,000,000 were paid off in 2012; and the growth in the loan portfolio is centered around commercial purpose and smaller commercial purpose type loans. In addition, there are certain loans that, although they did not meet the criteria for impairment, management believed there was a strong possibility that these loans represented probable losses at December 31, 2012.

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 2012 was $760,000 less than the provision for 2011. The provision for 2011 was $975,000 less than the provision for 2010. Management believes that the decreases in the provision reflect the modest improvements in the overall quality of the loan portfolio during the years.

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

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

Table 8 Analysis of Allowance for Loan Losses

	Years Ended December 31,				
Dollars in thousands	**2012**	**2011**	**2010**	**2009**	**2008**
Beginning balance	**$ 15,482**	$ 15,252	$ 11,981	$ 7,393	$ 5,848
Provision for loan losses	**4,675**	5,435	6,410	4,750	5,570
Loans charged-off:					
Commercial, financial and agricultural	**2,180**	1,861	204	221	1,169
Real estate	**955**	2,550	2,049	64	2,815
Consumer	**622**	832	928	63	68
Total Loans Charged-Off	**3,757**	5,243	3,181	348	4,052
Recoveries:					
Commercial, financial and agricultural	**22**	34	2	172	7
Real Estate	**399**				
Consumer	**4**	4	40	14	20
Total Recoveries	**425**	38	42	186	27
Net charge-offs	**3,332**	5,205	3,139	162	4,025
Ending balance	**$ 16,825**	$ 15,482	$ 15,252	$ 11,981	$ 7,393
Ratios:					
Net charge-offs to average loans	**0.48%**	0.77%	0.47%	0.03%	0.68%
Allowance for loan losses to total loans	**2.38%**	2.23%	2.29%	1.86%	1.16%

Table 9 Allocation of the Allowance for Loan Losses

	2012		**2011**		**2010**		**2009**		**2008**	
Dollars in thousands	**Amount**	**Percent of Loan Type to Total Loans**	**Amount**	**Percent of Loan Type to Total Loans**	**Amount**	**Percent of Loan Type to Total Loans**	**Amount**	**Percent of Loan Type to Total Loans**	**Amount**	**Percent of Loan Type to Total Loans**
Commercial, financial and agricultural	**$ 1,507**	**6.9%**	$ 2,582	8.1%	$ 2,074	7.9%	$ 1,539	7.1%	$ 1,383	9.4%
Real estate:										
Commercial	**6,576**	**34.4**	6,007	34.0	6,346	34.0	4,250	28.1	2,034	27.3
Construction	**518**	**2.7**	548	3.3	1,154	4.0	3,086	5.9	1,970	7.7
Residential	**3,721**	**53.9**	3,624	52.4	3,108	44.6	1,693	56.7	1,051	53.6
Consumer	**1,150**	**2.1**	926	2.3	861	9.5	403	2.2	325	2.0
Unallocated	**3,353**	**N/A**	1,795	N/A	1,709	N/A	1,010	N/A	630	N/A
Total	**$ 16,825**	**100.0%**	$ 15,482	100.0%	$ 15,252	100.0%	$ 11,981	100.0%	$ 7,393	100.0%

The allowance for loan losses at December 31, 2012, was $16,825,000, or 2.38% of loans, as compared to $15,482,000, or 2.23% of loans, at December 31, 2011. The ratio of non-performing loans plus foreclosed assets to total assets was 1.08% at December 31, 2012, as compared to 1.84% at December 31, 2011.

Loans past due 90 days and still accruing were $771,000 and nonaccrual loans were $6,327,000 as of December 31, 2012. Loans past due 90 days and still accruing were $1,191,000 at December 31, 2011, while nonaccruals were $12,846,000.

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Additional information on nonaccrual loans at December 31, 2012 and 2011, follows:

Dollars in thousands	Number of Credit Relationships	Balance	Current Specific Loss Allocations	Current Year Charge-Offs	Location	Originated	
December 31, 2012							
Residential real estate developments	**2**	**$ 854**	**$**	**$ 389**	**In market**	**2006**	**2010**
Owner occupied commercial real estate	**12**	**3,137**	**7**	**83**	**In market**	**1995**	**2010**
Investment/rental commercial real estate	**6**	**1,995**		**606**	**In market**	**2003**	**2011**
Commercial and industrial	**3**	**341**	**29**	**1,954**	**In market**	**2006**	**2010**
Total	**23**	**$ 6,327**	**$ 36**	**$ 3,032**			
December 31, 2011							
Residential real estate developments	3	$ 2,614	$	$ 1,155	In market	2006	2010
Owner occupied commercial real estate	13	6,469	43	1,196	In market	1995	2010
Investment/rental commercial real estate	5	1,544	53	286	In market	2003	2010
Commercial and industrial	3	2,219	1,085	1,664	In market	2006	2008
Total	24	$ 12,846	$ 1,181	$ 4,301			

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 2011 for purposes listed in the classification in the table above.

The Corporation has two unrelated impaired loans totaling $854,000 to finance residential real estate development projects in the Corporation's primary trading area of southcentral Pennsylvania, both of which were in nonaccrual of interest status. The loans have standard terms and conditions including repayment from the sales of the respective properties, and no interest reserves. Both loans were originated during the first half of 2006. In the previous year, one loan, originally $6,000,000, matured with the inability of the borrower to fund necessary infrastructure improvements. The Corporation charged down the loan by $2.5 million in 2008 and entered into a forbearance agreement on which the borrower performed until 2010 and then filed bankruptcy. ACNB further wrote down the loan by $1,000,000 in 2010 and $804,000 in 2011 reflecting alternative uses for the property and updated observed declines in fair value, respectively. The various real estate collateral on this loan was protected by a fair value bid at sheriff sale in 2012 after the properties were reappraised, resulting in a $381,000 net charge off. During 2012 the properties were written down to fair value less cost to sell and carried as foreclosed assets held for sale; subsequently one property was sold while three parcels remain unsold. On the other larger residential real estate loan, foreclosure has been held in abeyance while allowing the pursuit of a workout plan including providing additional collateral and more targeted marketing of the property. This loan was charged-down by $274,000 in the first quarter of 2011 due to declines in fair value and subsequently additional paydowns were made by the borrower from sales of collateral in 2011. Because of the 2011 write-downs and subsequent principal repayment, there was no specific valuation allowance on these two unrelated loans at December 31, 2012. Two smaller residential real estate development loans totaled $388,000 when added in 2010; one was settled with a charge down of $77,000 and subsequently sold without further loss, the other loan was reduced by collateral sales to $94,000, which is supported by the remaining collateral's current fair value. The respective allowances and write-downs were derived by estimating the cash flow from the sale of the property given the respective stage of completion and/or the zoning without required infrastructure.

Owner occupied commercial real estate includes 12 unrelated loan relationships, all of which have balances less than $700,000 each, in which real estate is collateral and is used in connection with a

business enterprise that is suffering economic stress or is out of business. These loans were originated between 1995 and 2010. Previously, the largest loan in this category had a balance of $3,508,000 at December 31, 2011, after a partial charge-off of $598,000 in the first quarter of 2011 due to uncertainty of when further legal collection could proceed. During 2012, this loan was settled with a $250,000 recovery of the 2011 charge-off. The remaining smaller loans in this category are business loans impacted by the general economic downturn. Collection efforts will continue until it is deemed in the best interest to initiate foreclosure procedures. One loan with a balance of $237,000 had a charge off of $39,000 and a specific allocation of $7,000 in 2012 based on a current appraisal less estimated cost to sell.

Investment/rental commercial real estate includes six unrelated loan relationships totaling less than $850,000 each in outstanding balance, in which the real estate is collateral, and are used for speculation, rental, or other non-owner occupied uses. These loans were originated between 2003 and 2011. These 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. Total charge-offs on investment/rental commercial real estate were $606,000 in 2012.

Included in impaired commercial and industrial loans is a fully-disbursed line of credit originated in the second quarter of 2007 for a start-up enterprise in the food industry in southcentral Pennsylvania totaling $187,000 with no specific valuation allowance at December 31, 2012, which is net of a $1,000,000 charge-off taken in 2008 and an additional charge-off of $529,000 in 2011. Subsequently, in the third quarter 2011, the borrower entered into an addendum to a prior delinquent forbearance agreement with all required principal forbearance payments made by the borrower. This loan, with standard terms and conditions including repayment from conversion of trade assets continues in default and in nonaccrual status. A second credit to an unrelated borrower was added in the third quarter of 2011 in the amount of $3,100,000 with a confirmed loss of $1,135,000, which was charged off in the fourth quarter of 2011. This 2006 participation loan was to a company in the building supplies industry that was negatively impacted by the downturn in housing and the more recent loss of a major distributorship. In the first quarter of 2012, the lead bank for this participation loan reported that the remaining accounts receivable that secured this loan were deemed worthless and ACNB charged off the entire remaining $1,954,000. The remaining smaller loans in this category are business loans impacted by the general economic downturn. The specific allocation of $29,000 at December 31, 2012, was derived by analyzing the latest borrower provided accounts receivable data, which was the collateral on the loan. One loan with an outstanding balance of $146,000 has an 80% government guarantee.

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 discussion and analysis create the recent loss history experience and in the qualitative adjustment which, in turn, affects the calculation of losses inherent in the portfolio. The provision for loan losses for 2012 compared to 2011 and 2010 was a result of the measurement of the adequacy of the allowance for loan

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losses at each period. Reasons that the 2011 provision was higher than 2012 include charge-offs and changes in allocations for specific loans. Reasons that 2011 was lower than 2010 included the charge-off of loans with specific allocations provided for in the prior year and favorable changes in the mix and credit classifications on other loans.

Foreclosed Assets Held for Resale

The carrying value of real estate acquired through foreclosure was $4,247,000 at December 31, 2012, compared to $4,437,000 at December 31, 2011. The decrease was mainly due to 11 properties that were disposed of in 2012. The largest property unsold at December 31, 2012, was an economic development property acquired in 2010 that had a sales contract expire at year-end 2012. Eight additional properties were added in 2012 and remain unsold at December 31, 2012, with an aggregate fair value of $1,442,000; six of these properties total $1,178,000 in combined fair value of properties obtained from two unrelated borrowers. The largest additions in 2011 remaining unsold were two unrelated local commercial real estate properties with combined fair values of $1,302,000 that are being marketed to the appropriate industries. All properties are actively being marketed. The Corporation expects to obtain and market additional foreclosed assets in 2013; however, the total amount and timing is currently not certain.

Other Assets

Other assets decreased $1,322,000, or 8%, in 2012 compared to 2011, primarily because of the decrease in accrued interest receivable and a variety of other smaller accounts.

Deposits

ACNB relies on deposits as the primary source of funds for lending activities. Average deposits increased 5%, or $37,780,000, during 2012, as compared to 3% during 2011. ACNB's deposit pricing function employs a disciplined pricing approach based upon alternative funding rates, but also strives to price deposits to be competitive with relevant local competition, including credit unions and larger regional banks. The 2012 deposit growth mix experienced a continued shift to transaction accounts as customers put more value in liquidity and FDIC insurance. Products, such as money market accounts and interest-bearing transaction accounts that had suffered declines in past years, continued with recovered balances. With persistent low market interest rates in a slow economy, ACNB's ability to maintain and add to its deposit base may be impacted by the reluctance of consumers to accept low rates and by competition willing to pay above market rates to attract market share. Alternatively, if rates rise rapidly and the equity markets would improve, funds could leave the Corporation or be priced higher to maintain.

Table 10 Time Deposits

Maturities of time deposits of $100,000 or more outstanding at December 31, 2012, are summarized as follows:

In thousands		
Three months or less	$	**21,823**
Over three through six months		**14,568**
Over six through twelve months		**28,062**
Over twelve months		**16,236**
Total	$	**80,689**

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Borrowings

Short-term borrowings are comprised primarily of securities sold under agreements to repurchase. As of December 31, 2012, short-term borrowings were $47,303,000, an increase of $1,341,000, or 3%, from the December 31, 2011, balance of $45,962,000. Agreements to repurchase accounts are with the commercial customer base and have attributes similar to core deposits. Investment securities are pledged in sufficient amounts to collateralize these agreements. Compared to year-end 2011, repurchase agreement balances were up due to normal fluctuations in the business activities of ACNB's commercial customer base and low competing rates in similar products. At December 31, 2012, there were no short-term FHLB borrowings, due to sufficient deposit funding. Long-term borrowings consist primarily of longer-term advances from the FHLB that contribute to a more balanced net repricing position; in addition, they include a loan from a commercial bank to fund the purchase of RIG. Long-term borrowings totaled $59,954,000 at December 31, 2012, versus $71,191,000 at December 31, 2011. The Corporation decreased long-term borrowings by paying off maturing FHLB advances from increased core deposits.

In thousands	**2012**	**2011**	**2010**
Amounts outstanding at end of year:			
Securities sold under repurchase agreements	**$ 47,303**	$ 45,962	$ 37,263
Treasury tax and loan note			1,823
Total	**$ 47,303**	$ 45,962	$ 39,086

Dollars in thousands	**2012**	**2011**	**2010**
Average interest rate at year-end	**0.14%**	0.20%	0.23%
Maximum amount outstanding at any month-end	**$ 58,343**	$ 56,238	$ 52,577
Average amount outstanding	**$ 48,300**	$ 43,124	$ 42,849
Weighted average interest rate	**0.16%**	0.21%	0.28%

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 $101,264,000 at December 31, 2012, compared to $97,474,000 at December 31, 2011. Stockholders' equity increased during 2012 partially due to earnings retained in capital during 2012 and offset by a decrease in accumulated other comprehensive income (loss) resulting from the change in fair value of the assets in the available for sale investment portfolio and amounts associated with the pension plan.

The primary source of additional capital to ACNB is earnings retention, which represents net income less dividends declared. During 2012, ACNB retained $4,362,000, or 49%, of its net income, as compared to $3,990,000, or 47%, in 2011 and $3,913,000, or 46%, in 2010.

On January 24, 2011, the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan was introduced for stockholders of record. This plan provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. Cumulative to December 31, 2012, 37,025 shares were issued under this plan with proceeds in the amount of $552,000. Proceeds will be used for general corporate purposes.

ACNB is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly

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

Quantitative measures established by regulation to ensure capital adequacy require ACNB to maintain minimum amounts and ratios of total and Tier 1 capital to average assets. Management believes, as of December 31, 2012 and 2011, that ACNB's banking subsidiary met all minimum capital adequacy requirements to which it is subject and is categorized as "well capitalized". There are no conditions or events since the notification that management believes have changed the banking subsidiary's category.

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

While uncertainty exists in the final form of the U.S. rules implementing the Basel III framework, based on preliminary assessments of the proposed framework, ACNB believes the Corporation and its banking subsidiary will continue to exceed all estimated well-capitalized regulatory requirements over the course of the proposed phase-in period, and on a fully phased-in basis. ACNB will continue to review the final rules if and when promulgated, as well as will continue to analyze the impact of such rules on ACNB's capital, operations, and resources.

Table 11 Risk-Based Capital

The banking subsidiary's capital ratios are as follows:

	2012	**2011**	**To be Well Capitalized under Prompt Corrective Action Regulations**
Tier 1 leverage ratio (to average assets)	**8.14%**	8.24%	5.00%
Tier 1 risk-based capital ratio (to risk-weighted assets)	**12.80%**	12.07%	6.00%
Total risk-based capital ratio	**14.07%**	13.32%	10.00%

For further information on the actual and required capital amounts and ratios, please refer to Note N "Regulatory Matters" in the Notes to Consolidated Financial Statements.

Liquidity

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

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ACNB's funds are available from a variety of sources, including assets that are readily convertible such as interest bearing deposits with banks, maturities and repayments from the securities portfolio, scheduled repayments of loans receivable, the core deposit base, and the ability to borrow from the FHLB. At December 31, 2012, ACNB could borrow approximately $384,300,000 from the FHLB of which $326,300,000 was available. Because of various restrictions and requirements on utilizing the available balance, ACNB considers $230,000,000 to be the practicable additional borrowing capacity, which is considered to be sufficient for operational needs. The FHLB system is self-capitalizing, member-owned, and its member banks' stock is not publicly traded. ACNB creates its borrowing capacity with the FHLB by granting a security interest in certain loan assets with requisite credit quality. ACNB has reviewed information on the FHLB system and the FHLB of Pittsburgh, and has concluded that they have the capacity and intent to continue to provide both operational and contingency liquidity. The FHLB of Pittsburgh instituted a requirement that a member's investment securities must be moved into a safekeeping account under FHLB control to be considered in the calculation of maximum borrowing capacity. The Corporation currently has securities in safekeeping at the FHLB of Pittsburgh; however, the safekeeping account is under the Corporation's control. As better contingent liquidity is maintained by keeping the securities under the Corporation's control, the Corporation has not moved the securities which, in effect, lowered the Corporation's maximum borrowing capacity. However, there is no practical reduction in borrowing capacity as the securities can be moved into the FHLB-controlled account promptly if they are needed for borrowing purposes.

Another source of liquidity is securities sold under repurchase agreement to customers of ACNB's banking subsidiary totaling $47,303,000 and $45,962,000 at December 31, 2012 and 2011, respectively.

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

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

Aggregate Contractual Obligations

The following table represents the Corporation's on- and off-balance sheet aggregate contractual obligations to make future payments as of December 31, 2012:

In thousands	Less than 1 Year	1 - 3 Years	4 - 5 Years	Over 5 Years	Total
Time deposits	$ 209,937	$ 55,633	$ 6,138	$	$ 271,708
Short term borrowings	47,303				47,303
Long-term debt	14,251	29,546	13,610	2,547	59,954
Operating leases	409	728	378	472	1,987
Payments under nonqualified benefit plans	133	200	169	6,680	7,182
Total	$ 272,033	$ 86,107	$ 20,295	$ 9,699	$ 388,134

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

Off-Balance Sheet Arrangements

The Corporation is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and, to a lesser extent, standby letters of credit. At December 31, 2012, the Corporation had unfunded outstanding commitments to extend credit of $145,421,000 and outstanding standby letters of credit of $4,772,000. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. Please refer to Note O "Financial Instruments with Off-balance Sheet Risk" in the Notes to Consolidated Financial Statements for a discussion of the nature, business purpose, and importance of the Corporation's off-balance sheet arrangements.

New Accounting Pronouncements

See Note A "Summary of Significant Accounting Policies" in the Notes to the Consolidated Financial Statements for a summary of these new accounting pronouncements not yet adopted.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

Interest Rate Risk

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

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

Management endeavors to control the exposure to changes in interest rates by understanding, reviewing and making decisions based on its risk position. The banking subsidiary's asset/liability

committee is responsible for these decisions. The Corporation primarily uses the securities portfolio and FHLB advances to manage its interest rate risk position. Additionally, pricing, promotion and product development activities are directed in an effort to emphasize the loan and deposit term or repricing characteristics that best meet current interest rate risk objectives. At present, there is no use of hedging instruments.

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

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

Earnings at Risk

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

The simulation analysis results are presented in Table 13a. These results, as of December 31, 2012, indicate that the Corporation would expect net interest income to increase over the next twelve months by 2.07% assuming an upward ramp in market interest rates of 3.00%, and to decrease by 8.06% if rates ramped downward 3.00%. This profile reflects an acceptable short-term interest rate risk position. A decrease of 3.00% would create an environment in which deposit rates could not practically decline further, thus decreasing net interest income.

Earnings at risk simulations for December 31, 2012, exhibited similar sensitivity in a declining rate environment reflecting an interest rate environment in which larger rate declines could be accommodated.

Value at Risk

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

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The net present value analysis results are presented in Table 13b. These results, as of December 31, 2012, indicate that the net present value would increase 2.03% assuming an upward shift in market interest rates of 3.00% and increase 2.93% if rates shifted 1.00% in the same manner.

December 31, 2012 Table 13a Net Interest Income Projections		**December 31, 2012 Table 13b Present Value of Equity**	
Changes in Basis Points	**% Change**	**Changes in Basis Points**	**% Change**
(300)	**(8.06)%**	**(300)**	**(7.79)%**
(100)	**(2.82)%**	**(100)**	**(2.56)%**
100	**0.81 %**	**100**	**2.93 %**
300	**2.07 %**	**300**	**2.03 %**

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

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ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

	Page
Report of Independent Registered Public Accounting Firm	58
Consolidated Statements of Condition	59
Consolidated Statements of Income	60
Consolidated Statements of Comprehensive Income	61
Consolidated Statements of Changes in Stockholders' Equity	62
Consolidated Statements of Cash Flows	63
Notes to Consolidated Financial Statements	64

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated statements of condition of ACNB Corporation and Subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2012. ACNB Corporation's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ACNB Corporation and Subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), ACNB Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2013, expressed an unqualified opinion.

ParenteBeard LLC
Harrisburg, Pennsylvania
March 15, 2013

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ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CONDITION

Dollars in thousands, except per share data	December 31, 2012	2011
ASSETS		
Cash and due from banks	**$ 19,078**	$ 14,423
Interest bearing deposits with banks	**32,307**	8,200
Cash and Cash Equivalents	**51,385**	22,623
Securities available for sale	**165,790**	209,227
Securities held to maturity, fair value $50,980; $10,680	**50,159**	10,032
Loans held for sale	**6,687**	337
Loans, net of allowance for loan losses $16,825; $15,482	**691,311**	678,986
Premises and equipment	**15,131**	14,483
Restricted investment in bank stocks	**5,318**	7,146
Investment in bank-owned life insurance	**31,122**	28,411
Investments in low-income housing partnerships	**5,440**	3,774
Goodwill	**6,308**	6,308
Intangible assets	**2,409**	3,049
Foreclosed assets held for resale	**4,247**	4,437
Other assets	**14,688**	16,010
Total Assets	**$ 1,049,995**	$ 1,004,823
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing	**$ 119,297**	$ 112,247
Interest bearing	**714,879**	670,548
Total Deposits	**834,176**	782,795
Short-term borrowings	**47,303**	45,962
Long-term borrowings	**59,954**	71,191
Other liabilities	**7,298**	7,401
Total Liabilities	**948,731**	907,349
STOCKHOLDERS' EQUITY		
Common stock, $2.50 par value; 20,000,000 shares authorized; 6,027,968 and 6,008,409 shares issued; 5,965,368 and 5,945,809 shares outstanding	**15,070**	15,021
Treasury stock, at cost (62,600 shares)	**(728)**	(728)
Additional paid-in capital	**9,246**	9,000
Retained earnings	**77,888**	73,526
Accumulated other comprehensive (loss) income	**(212)**	655
Total Stockholders' Equity	**101,264**	97,474
Total Liabilities and Stockholders' Equity	**$ 1,049,995**	$ 1,004,823

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

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ACNB CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

Dollars in thousands, except per share data	Years Ended December 31, 2012	2011	2010
INTEREST INCOME			
Loans, including fees	**$ 33,990**	$ 34,493	$ 36,043
Securities:			
Taxable	**4,876**	6,006	7,181
Tax-exempt	**1,457**	1,252	1,308
Dividends	**27**	13	26
Other	**89**	68	82
Total Interest Income	**40,439**	41,832	44,640
INTEREST EXPENSE			
Deposits	**3,441**	4,457	6,223
Short-term borrowings	**76**	91	119
Long-term borrowings	**2,578**	2,914	3,281
Total Interest Expense	**6,095**	7,462	9,623
Net Interest Income	**34,344**	34,370	35,017
PROVISION FOR LOAN LOSSES	**4,675**	5,435	6,410
Net Interest Income after Provision for Loan Losses	**29,669**	28,935	28,607
OTHER INCOME			
Service charges on deposit accounts	**2,433**	2,418	2,415
Income from fiduciary activities	**1,224**	1,396	1,303
Earnings on investment in bank-owned life insurance	**981**	968	1,002
Gain on life insurance proceeds	**63**		78
Gains on sales/calls of securities	**7**	1	72
Service charges on ATM and debit card transactions	**1,291**	1,236	1,124
Commissions from insurance sales	**4,835**	4,824	4,949
Other	**1,033**	894	1,229
Total Other Income	**11,867**	11,737	12,172
OTHER EXPENSES			
Salaries and employee benefits	**18,553**	17,138	17,318
Net occupancy	**1,952**	2,043	2,197
Equipment	**2,537**	2,620	2,499
Professional services	**825**	911	1,116
Other tax	**833**	803	791
Supplies and postage	**634**	640	717
Marketing	**372**	478	458
FDIC and regulatory	**843**	1,026	1,434
Intangible assets amortization	**641**	641	641
Foreclosed real estate (income) expenses	**(119)**	725	292
Other operating	**3,260**	2,991	2,840
Total Other Expenses	**30,331**	30,016	30,303

Income Before Income Taxes		**11,205**		10,656		10,476
PROVISION FOR INCOME TAXES		**2,319**		2,154		2,057
Net Income	**$**	**8,886**	$	8,502	$	8,419
PER SHARE DATA						
Basic earnings	**$**	**1.49**	$	1.43	$	1.42
Cash dividends declared	**$**	**0.76**	$	0.76	$	0.76

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

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ACNB CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Years Ended December 31,		
In thousands	**2012**	**2011**	**2010**
NET INCOME	**$ 8,886**	$ 8,502	$ 8,419
OTHER COMPREHENSIVE (LOSS) INCOME			
SECURITIES			
Unrealized (losses) gains arising during the period, net of income taxes of $(197), $1,067, and $(123), respectively	**(377)**	2,074	(235)
Reclassification adjustment for net gains included in net income, net of income taxes of $(2), $0, and $(24), respectively	**(5)**	(1)	(48)
PENSION			
Change in plan assets and benefit obligations, net of income taxes of $(247), $(1,338), and $939, respectively	**(485)**	(2,600)	1,821
TOTAL OTHER COMPREHENSIVE (LOSS) INCOME	**(867)**	(527)	1,538
TOTAL COMPREHENSIVE INCOME	**$ 8,019**	$ 7,975	$ 9,957

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

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ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 2012, 2011 and 2010

Dollars in thousands	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
BALANCE January 1, 2010	$ 14,977	$ (728)	$ 8,787	$ 65,623	$ (356)	$ 88,303
Net income				8,419		8,419
Other comprehensive income, net of taxes					1,538	1,538
Cash dividends declared				(4,506)		(4,506)
BALANCE December 31, 2010	14,977	(728)	8,787	69,536	1,182	93,754
Net income				8,502		8,502
Other comprehensive loss, net of taxes					(527)	(527)
Common stock shares issued (17,466 shares)	44		213			257
Cash dividends declared				(4,512)		(4,512)
BALANCE December 31, 2011	15,021	(728)	9,000	73,526	655	97,474
Net income				**8,886**		**8,886**
Other comprehensive loss, net of taxes					**(867)**	**(867)**
Common stock shares issued (19,559 shares)	**49**		**246**			**295**
Cash dividends declared				**(4,524)**		**(4,524)**
BALANCE December 31, 2012	**$ 15,070**	**$ (728)**	**$ 9,246**	**$ 77,888**	**$ (212)**	**$ 101,264**

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

In thousands	Years Ended December 31, 2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	**$ 8,886**	$ 8,502	$ 8,419
Adjustments to reconcile net income to net cash provided by operating activities:			
Net (gain) loss on sales of loans and foreclosed real estate, net of write-downs on foreclosed real estate	**(696)**	38	(275)
Earnings on investment in bank-owned life insurance	**(981)**	(968)	(1,002)
Gain on sales/calls of securities	**(7)**	(1)	(72)
Gain on life insurance proceeds	**(63)**		(78)
Depreciation and amortization	**2,041**	2,218	2,342
Provision for loan losses	**4,675**	5,435	6,410
Net amortization of investment securities premiums	**893**	682	150
Decrease (increase) in interest receivable	**329**	(257)	241
Decrease in interest payable	**(315)**	(238)	(455)
Mortgage loans originated for sale	**(32,316)**	(15,414)	(38,877)
Proceeds from loans sold to others	**26,262**	18,403	36,394
Decrease (increase) in other assets	**1,880**	3,857	(5,872)
(Decrease) increase in other liabilities	**(1,285)**	(4,103)	1,583
Net Cash Provided by Operating Activities	**9,303**	18,154	8,908
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from maturities of investment securities held to maturity	**2,399**		
Proceeds from maturities of investment securities available for sale	**62,589**	55,804	67,442
Proceeds from sales of investment securities available for sale			6,561
Purchase of investment securities available for sale	**(19,676)**	(71,830)	(55,356)
Purchase of investments held to maturity	**(42,705)**		
Redemption of restricted investment in bank stocks	**1,828**	1,274	750
Net increase in loans	**(19,521)**	(37,672)	(26,620)
Investment in low-income housing project	**(2,106)**		
Purchase of bank-owned life insurance	**(1,940)**		(250)
Insurance agency acquisitions, net of cash acquired		(336)	(31)
Proceeds from life insurance death benefits	**273**		295
Capital expenditures	**(2,049)**	(1,942)	(1,089)
Proceeds from sale of property and foreclosed real estate	**3,111**	6,416	928
Net Cash Used in Investing Activities	**(17,797)**	(48,286)	(7,370)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in demand deposits	**7,050**	8,783	9,635
Net increase in time certificates of deposits and interest bearing deposits	**44,331**	27,486	8,368
Net increase (decrease) in short-term borrowings	**1,341**	6,876	(16,205)
Proceeds from long-term borrowings	**10,000**		22,000
Repayments on long-term borrowings	**(21,237)**	(10,308)	(20,795)
Dividends paid	**(4,524)**	(4,512)	(4,506)
Common stock issued	**295**	257	
Net Cash Provided by (Used in) Financing Activities	**37,256**	28,582	(1,503)
Net Increase (Decrease) in Cash and Cash Equivalents	**28,762**	(1,550)	35

CASH AND CASH EQUIVALENTS BEGINNING		**22,623**		24,173		24,138
CASH AND CASH EQUIVALENTS ENDING	**$**	**51,385**	$	22,623	$	24,173
Interest paid	**$**	**6,410**	$	7,700	$	10,078
Income taxes paid	**$**	**725**	$	1,700	$	2,300
Loans transferred to foreclosed real estate	**$**	**2,521**	$	3,290	$	2,877

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

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ACNB CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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

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

The Corporation, along with seven other banks, entered into a joint venture to form BankersRe Insurance Group, SPC (formerly Pennbanks Insurance Co., SPC), an offshore reinsurance company. Each participating entity owned an insurance cell through which its premiums and losses from credit life, health and accident insurance are funded. Each entity was responsible for the activity in its respective cell. The financial activity for the Corporation's insurance cell is included in the consolidated financial statements and is not material to the consolidated financial statements. The segregated portfolio was novated to a third party during 2012.

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

Basis of Financial Statements

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

Assets held by the Corporation's Trust Department in an agency or fiduciary capacity for its customers are excluded from the consolidated financial statements since they do not constitute assets of the Corporation. Assets held by the Trust Department amounted to $141,000,000 and $135,000,000 at December 31, 2012 and 2011, respectively. Income from fiduciary activities is recognized on the cash method, which approximates the accrual method.

Certain amounts previously reported have been reclassified, when necessary, to conform to the financial statement presentation for 2012. The reclassifications had no effect on net income or stockholders' equity.

The Corporation has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2012, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

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

Significant Group Concentrations of Credit Risk

Most of the Corporation's activities are with customers located within southcentral Pennsylvania and northern Maryland. Note C discusses the types of securities in which the Corporation invests. Note D discusses the types of lending in which the Corporation engages. Included in commercial real estate loans are loans made to lessors of non-residential dwellings that total $100,100,000, or 14%, of total loans at December 31, 2012. These borrowers are geographically disbursed throughout ACNB's marketplace and are leasing commercial properties to a varied group of tenants including medical offices, retail space and recreational facilities. Because of the varied nature of the tenants in aggregate, management believes that these loans do not present any greater risk than commercial loans in general.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, balances due from banks, and federal funds sold, all of which mature within 90 days.

Securities

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

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

Restricted Investment in Bank Stocks

Restricted investment in bank stocks, which represents required investments in the common stock of correspondent banks, is carried at cost as of December 31, 2012 and 2011, and consists of common stock in the Atlantic Central Bankers Bank and Federal Home Loan Bank (FHLB). In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Management believes no impairment charge was necessary related to the restricted investment in bank stocks during 2012, 2011 or 2010. However, security impairment analysis is completed quarterly, and the determination that no impairment has occurred during those years is no assurance that impairment may not occur in future periods.

Loans Held for Sale

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

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

Loans

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

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

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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Allowance for Credit Losses

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses (the "allowance") is established as losses and 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 statements.

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

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

- lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices;
- national, regional and local economic and business conditions, as well as the condition of various market segments, including the impact on the value of underlying collateral for collateral dependent loans;
- the nature and volume of the portfolio and terms of loans;
- the experience, ability and depth of lending management and staff;

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- the volume and severity of past due, classified and nonaccrual loans, as well as other loan modifications; and,
- the existence and effect of any concentrations of credit and changes in the level of such concentrations.

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

The unallocated component of the allowance is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. 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 or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and commercial construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

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

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

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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, the reliability and predictability of the cash flow generated by the project using feasibility studies, market data, etc. Appraisals on properties securing commercial real estate construction loans originated by the Corporation are performed by independent appraisers.

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

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

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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In underwriting one-to-four family residential real estate loans, the Corporation evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Properties securing real estate loans made by the Corporation are appraised by independent appraisers. The Corporation generally requires borrowers to obtain an attorney's title opinion or title insurance, as well as fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. The Corporation has not engaged in subprime residential mortgage originations. Residential mortgage loans present a moderate level of risk due primarily to general economic conditions, as well as a currently weakened housing market.

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

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

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

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

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

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

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

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Off-Balance Sheet Credit-Related Financial Instruments

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

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are adjusted to the fair value, less costs to sell as necessary. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

Premises and Equipment

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

Investments in Low-Income Housing Partnerships

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

Bank-Owned Life Insurance

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

ASC Topic 715, *Compensation Retirement Benefits*, requires a liability to be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability is based on either the post-employment benefit cost for continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. The Corporation's liability is based on the post-employment benefit cost for continuing life insurance. The Corporation incurred approximately $28,000, $22,000, and $48,000 of expense in 2012, 2011, and 2010, respectively, related to these benefits.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Income Taxes

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

Current income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Corporation determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

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

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

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

Retirement Plan

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

Net Income per Share

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 5,953,723, 5,936,030 and 5,928,343 weighted average shares of common stock outstanding for 2012, 2011 and 2010, respectively.

Advertising Costs

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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Intangible Assets

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

ASC Topic 350, *Intangibles Goodwill and Other,* requires that goodwill is not amortized to expense, but rather that it be assessed for impairment at least annually. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. During the quarter ended June 30, 2012, the Corporation changed its method of applying ASC 350, such that the annual goodwill impairment testing date was changed from December 31 to October 1. This new testing date is preferable in the circumstances, because it allowed the Corporation more time to accurately complete its impairment testing process in order to incorporate the results in the annual consolidated financial statements. The Corporation did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of October 1, 2012. 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.

Accumulated Other Comprehensive Income (Loss)

The components of the 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 DECEMBER 31, 2011	$ 5,996	$ (5,341)	$ 655
BALANCE DECEMBER 31, 2012	**$ 5,614**	**$ (5,826)**	**$ (212)**

Segment Reporting

The Bank acts as an independent community financial services provider, which offers traditional banking and related financial services to individual business and government customers. Through its branch and automated teller machine networks, the Bank offers a full array of commercial and retail financial services, including the taking of time, savings, and demand deposits; the making of commercial, consumer, and mortgage loans; and the providing of other financial services. Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial, retail and mortgage banking operations of the Bank. As such, discrete financial information for commercial, retail and mortgage banking operations is not available and segment reporting would not be meaningful. Please refer to Note S "Segment and Related Information" for a discussion of insurance operations.

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

New Accounting Pronouncements

ASU 2013-02

In December 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2013-02, *Comprehensive Income (Topic 220) Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The objective of this ASU is to improve the reporting of reclassifications out of accumulated other comprehensive income. This ASU requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income, by component, on the respective line items in the income statement if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. Reclassifications that are not required under U.S. GAAP to be reclassified in their entirety to net income in the same reporting period are required to be cross-referenced to other U.S. GAAP disclosures that provide additional detail about those amounts. This is the case when a portion of the amount reclassified out of accumulated other comprehensive income is reclassified to a balance sheet account rather than directly to income or expense in the same reporting period. For example, some portion of net periodic pension cost is immediately reported in net income, but other portions may be capitalized to an asset balance such as fixed assets or inventory. An entity with significant defined benefit pension costs reclassified out of accumulated other comprehensive income but not to net income in its entirety in the same reporting period should identify the amount of each pension cost component reclassified out of accumulated other comprehensive income and make reference to the relevant pension cost disclosure that provides greater detail about these reclassifications.

The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income.

The provisions of this ASU are effective for public entities prospectively for reporting periods beginning after December 15, 2012. Early adoption is permitted.

The Corporation has included these reclassification adjustments in the consolidated financial statements contained herein.

NOTE B RESTRICTIONS ON CASH AND DUE FROM BANKS

In return for services obtained through correspondent banks, the Corporation is required to maintain non-interest bearing cash balances in those correspondent banks. At December 31, 2012 and 2011, compensating balances approximated $1,969,000 and $2,085,000, respectively. During 2012 and 2011, average compensating balances approximated $2,327,000 and $2,611,000, respectively. All compensating balances are met by vault cash.

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NOTE C SECURITIES

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

In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
December 31, 2012				
U.S. Government and agencies	**$ 23,225**	**$ 1,016**	**$**	**$ 24,241**
Mortgage-backed securities	**75,816**	**4,767**		**80,583**
State and municipal	**49,568**	**2,246**	**10**	**51,804**
Corporate bonds	**7,008**	**286**	**8**	**7,286**
CRA mutual fund	**1,044**	**52**		**1,096**
Stock in other banks	**627**	**153**		**780**
	$ 157,288	**$ 8,520**	**$ 18**	**$ 165,790**
December 31, 2011				
U.S. Government and agencies	$ 39,237	$ 932	$	$ 40,169
Mortgage-backed securities	102,059	5,473	5	107,527
State and municipal	44,072	2,250	5	46,317
Corporate bonds	13,105	304	30	13,379
CRA mutual fund	1,044	37		1,081
Stock in other banks	627	127		754
	$ 200,144	$ 9,123	$ 40	$ 209,227
SECURITIES HELD TO MATURITY				
December 31, 2012				
U.S. Government and agencies	**$ 30,115**	**$ 536**	**$ 6**	**$ 30,645**
Mortgage-backed securities	**20,044**	**298**	**7**	**20,335**
	$ 50,159	**$ 834**	**$ 13**	**$ 50,980**
December 31, 2011				
U.S. Government and agencies	$ 10,032	$ 648	$	$ 10,680

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NOTE C SECURITIES (Continued)

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

	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						
December 31, 2012						
State and municipal	**$ 1,975**	**$ 10**	**$**	**$**	**$ 1,975**	**$ 10**
Corporate bond	**992**	**8**			**992**	**8**
	$ 2,967	**$ 18**	**$**	**$**	**$ 2,967**	**$ 18**
December 31, 2011						
Mortgage-backed securities	$ 1,968	$ 5	$	$	$ 1,968	$ 5
State and municipal	1,251	5			1,251	5
Corporate bonds			970	30	970	30
	$ 3,219	$ 10	$ 970	$ 30	$ 4,189	$ 40
SECURITIES HELD TO MATURITY						
December 31, 2012						
U.S. Government and agencies	$ 2,994	$ 6	$	$	$ 2,994	$ 6
Mortgage-backed security	2,046	7			2,046	7
	$ 5,040	$ 13	$	$	$ 5,040	$ 13

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

At December 31, 2012, five available for sale state and municipal securities had unrealized losses, and none of the municipal securities had been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of specific securities. None of the securities in this category had an unrealized loss that exceeded 1% of amortized cost.

At December 31, 2012, one available for sale corporate bond security had an unrealized loss and 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. This security had an unrealized loss of less than 1% of amortized cost.

At December 31. 2012, two held to maturity U.S. Government and agency securities had unrealized losses that individually did not exceed 1% of amortized cost. These securities have not been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of specific securities.

At December 31, 2012, one held to maturity mortgage-backed security had an unrealized loss that individually did not exceed 1% of amortized cost. This security has not been in a continuous loss position for 12 months or more. This unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the specific security.

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NOTE C SECURITIES (Continued)

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 December 31, 2012, 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 securities, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management's intention and ability to hold the securities until recovery of unrealized losses.

Amortized cost and fair value at December 31, 2012, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	Available for Sale		Held to Maturity	
In thousands	Amortized Cost	Fair Value	Amortized Cost	Fair Value
1 year or less	$ 1,301	$ 1,304	$	$
Over 1 year through 5 years	32,769	34,524	17,104	17,571
Over 5 years through 10 years	41,700	43,190	13,011	13,074
Over 10 years	4,031	4,313		
Mortgage-backed securities	75,816	80,583	20,044	20,335
CRA mutual fund	1,044	1,096		
Stock in other banks	627	780		
	$ 157,288	$ 165,790	$ 50,159	$ 50,980

The Corporation realized gross gains of $7,000 during 2012, $1,000 during 2011, and $128,000 during 2010 and gross losses of $0 during 2012, $0 during 2011 and $56,000 during 2010 on sales or calls of securities available for sale. State and municipal securities were sold at a gain in 2010 in order to adjust the Corporation's interest rate sensitivity, reduce exposure to geographic locations, balance the mix with other investment types and to reduce risks related to insurance coverage.

At December 31, 2012 and 2011, securities with a carrying value of $147,923,000 and $124,069,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements and for other purposes.

NOTE D LOANS

The Bank grants commercial, residential and consumer loans to customers primarily within southcentral Pennsylvania and northern Maryland and the surrounding area. A large portion of the

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NOTE D LOANS (Continued)

loan portfolio is secured by real estate. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy.

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Corporation's internal risk rating system as of December 31, 2012 and 2011:

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2012					
Commercial and industrial	**$ 44,072**	**$ 2,491**	**$ 2,441**	**$**	**$ 49,004**
Commercial real estate	**205,449**	**20,379**	**17,191**		**243,019**
Commercial real estate construction	**7,354**	**9,820**	**1,980**		**19,154**
Residential mortgage	**321,986**	**4,502**	**2,348**		**328,836**
Home equity lines of credit	**51,096**	**1,776**	**258**		**53,130**
Consumer	**14,993**				**14,993**
Total	**$ 644,950**	**$ 38,968**	**$ 24,218**	**$**	**$ 708,136**
December 31, 2011					
Commercial and industrial	$ 48,284	$ 4,596	$ 3,265	$	$ 56,145
Commercial real estate	200,834	19,872	15,311		236,017
Commercial real estate construction	7,400	12,743	2,614		22,757
Residential mortgage	304,627	4,261	2,378		311,266
Home equity lines of credit	50,083	2,364	85		52,532
Consumer	15,751				15,751
Total	$ 626,979	$ 43,836	$ 23,653	$	$ 694,468

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

	Impaired Loans with Allowance			Impaired Loans with No Allowance	
In thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
December 31, 2012					
Commercial and industrial	**$ 146**	**$ 146**	**$ 29**	**$ 195**	**$ 1,310**
Commercial real estate	**237**	**276**	**7**	**8,772**	**9,216**
Commercial real estate construction				**854**	**1,128**
Residential mortgage				**938**	**1,263**
Total	**$ 383**	**$ 422**	**$ 36**	**$ 10,759**	**$ 12,917**
December 31, 2011					
Commercial and industrial	$ 1,967	$ 3,102	$ 1,085	$ 252	$ 1,367
Commercial real estate	273	273	43	6,339	7,136
Commercial real estate construction				2,614	7,192
Residential mortgage	88	88	53	1,313	1,638
Total	$ 2,328	$ 3,463	$ 1,181	$ 10,518	$ 17,333

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NOTE D LOANS (Continued)

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

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

In thousands	Impaired Loans with Allowance Average Recorded Investment	Impaired Loans with Allowance Interest Income	Impaired Loans with No Allowance Average Recorded Investment	Impaired Loans with No Allowance Interest Income
December 31, 2012				
Commercial and industrial	**$ 431**	**$**	**$ 223**	**$**
Commercial real estate	**691**		**8,193**	**11**
Commercial real estate construction	**336**		**1,242**	
Residential mortgage	**18**		**1,390**	
Total	**$ 1,476**	**$**	**$ 11,048**	**$ 11**
December 31, 2011				
Commercial and industrial	$ 1,019	$	$ 349	$
Commercial real estate	2,324		4,946	44
Commercial real estate construction			3,463	
Residential mortgage	340		1,119	
Total	$ 3,683	$	$ 9,877	$ 44
December 31, 2010				
Commercial and industrial	$ 904	$	$ 66	$
Commercial real estate	1,166	6	3,661	29
Commercial real estate construction	4,882	61	562	
Residential mortgage	24		1,339	4
Total	$ 6,976	$ 67	$ 5,628	$ 33

If interest on all nonaccrual loans had been accrued at original contract rates, interest income would have increased by $543,000 in 2012, $652,000 in 2011, and $464,000 in 2010.

The following table presents nonaccrual loans by classes of the loan portfolio as of December 31, 2012 and 2011:

In thousands	2012	2011
Commercial and industrial	**$ 341**	$ 2,219
Commercial real estate	**4,515**	6,612
Commercial real estate construction	**854**	2,614
Residential mortgage	**617**	1,401
Total	**$ 6,327**	$ 12,846

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NOTE D LOANS (Continued)

The following table summarizes information in regards to troubled debt restructurings by loan portfolio class at December 31, 2012 and 2011:

In thousands	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments	Recorded Investment
December 31, 2012			
Nonaccruing troubled debt restructurings:			
Commercial and industrial	**$ 490**	**$ 485**	**$ 187**
Commercial real estate	**1,304**	**1,304**	**953**
Commercial real estate construction	**1,548**	**1,541**	**760**
Total nonaccruing troubled debt restructurings	**3,342**	**3,330**	**1,900**
Accruing troubled debt restructurings:			
Commercial real estate	**4,577**	**4,577**	**4,494**
Residential mortgage	**336**	**336**	**321**
Total accruing troubled debt restructurings	**4,913**	**4,913**	**4,815**
Total Troubled Debt Restructurings	**$ 8,255**	**$ 8,243**	**$ 6,715**
December 31, 2011			
Nonaccruing troubled debt restructurings:			
Commercial and industrial	$ 490	$ 485	$ 234
Commercial real estate	656	656	412
Commercial real estate construction	1,548	1,541	850
Total Troubled Debt Restructurings	$ 2,694	$ 2,682	$ 1,496

All of the Corporation's troubled debt restructured loans are also impaired loans, which resulted in a specific allocation and, subsequently, a charge-off as appropriate. As of December 31, 2011, charge-offs associated with troubled debt restructured loans while under a forbearance agreement totaled $589,000. An additional charge-off in the amount of $39,000 occurred during the first quarter of 2012. As of December 31, 2012, there was one defaulted troubled debt restructure and all other troubled debt restructured loans were current with respect to their associated forbearance agreements. One forbearance agreement was negotiated during 2009 and modified during 2011, two were negotiated during 2010, one was negotiated during 2011, while the other three were negotiated during 2012.

There are forbearance agreements on all loans currently classified as troubled debt restructures, and all of these agreements have resulted in additional principal repayment. The terms of these forbearance