ACNB CORP
Form 10-Q
July 29, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

Commission file number 0-11783

ACNB CORPORATION

(Exact name of Registrant as specified in its charter)

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

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

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

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

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

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

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

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

The number of shares of the Registrant s Common Stock outstanding on July 29, 2016, was 6,056,806.

PART I - FINANCIAL INFORMATION

ACNB CORPORATION

ITEM 1 - FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

Dollars in thousands, except per share data	June 30, 2016	June 30, 2015	December 31, 2015
ASSETS			
Cash and due from banks	**$ 14,299**	$ 12,995	$ 13,468
Interest bearing deposits with banks	**31,919**	15,002	5,289
Total Cash and Cash Equivalents	**46,218**	27,997	18,757
Securities available for sale	**117,001**	107,241	125,693
Securities held to maturity, fair value $60,897; $75,665; $71,363	**59,681**	75,719	71,542
Loans held for sale	**955**	916	1,835
Loans, net of allowance for loan losses $14,636; $14,865; $14,747	**852,196**	802,134	838,213
Premises and equipment	**18,965**	17,676	18,044
Restricted investment in bank stocks	**4,351**	4,058	4,414
Investment in bank-owned life insurance	**40,200**	38,489	39,642
Investments in low-income housing partnerships	**3,120**	3,569	3,345
Goodwill	**6,308**	6,308	6,308
Intangible assets	**859**	1,203	1,033
Foreclosed assets held for resale	**730**	1,504	580
Other assets	**18,526**	19,437	18,519
Total Assets	**$ 1,169,110**	$ 1,106,251	$ 1,147,925
LIABILITIES AND STOCKHOLDERS EQUITY			
LIABILITIES			
Deposits:			
Non-interest bearing	**$ 177,366**	$ 157,562	$ 166,224
Interest bearing	**744,861**	714,607	746,756
Total Deposits	**922,227**	872,169	912,980
Short-term borrowings	**36,190**	34,402	35,202
Long-term borrowings	**80,500**	78,799	76,500
Other liabilities	**10,916**	7,980	8,528
Total Liabilities	**1,049,833**	993,350	1,033,210
STOCKHOLDERS EQUITY			
Preferred stock, $2.50 par value; 20,000,000 shares authorized; no shares outstanding			
Common stock, $2.50 par value; 20,000,000 shares authorized; 6,119,406, 6,092,708 and 6,102,324 shares issued; 6,056,806, 6,030,108 and 6,039,724 shares outstanding	**15,299**	15,232	15,256

Treasury stock, at cost (62,600 shares)		**(728)**		(728)		(728)
Additional paid-in capital		**10,746**		10,209		10,387
Retained earnings		**97,638**		91,275		94,526
Accumulated other comprehensive loss		**(3,678)**		(3,087)		(4,726)
Total Stockholders Equity		**119,277**		112,901		114,715
Total Liabilities and Stockholders Equity	**$**	**1,169,110**	$	1,106,251	$	1,147,925

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

Dollars in thousands, except per share data	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
INTEREST INCOME				
Loans, including fees	**$ 8,983**	$ 8,965	**$ 17,904**	$ 17,557
Securities:				
Taxable	**782**	785	**1,590**	1,594
Tax-exempt	**161**	221	**340**	452
Dividends	**55**	49	**106**	214
Other	**29**	25	**34**	39
Total Interest Income	**10,010**	10,045	**19,974**	19,856
INTEREST EXPENSE				
Deposits	**570**	533	**1,128**	1,032
Short-term borrowings	**12**	11	**28**	28
Long-term borrowings	**398**	445	**781**	899
Total Interest Expense	**980**	989	**1,937**	1,959
Net Interest Income	**9,030**	9,056	**18,037**	17,897
PROVISION FOR LOAN LOSSES				
Net Interest Income after Provision for Loan Losses	**9,030**	9,056	**18,037**	17,897
OTHER INCOME				
Service charges on deposit accounts	**575**	584	**1,103**	1,110
Income from fiduciary activities	**434**	377	**828**	740
Earnings on investment in bank-owned life insurance	**290**	285	**558**	547
Net gains on sales or calls of securities		101		101
Gain on sales of premises and equipment	**449**		**449**	
Service charges on ATM and debit card transactions	**391**	393	**746**	754
Commissions from insurance sales	**1,328**	1,227	**2,431**	2,280
Other	**344**	272	**568**	500
Total Other Income	**3,811**	3,239	**6,683**	6,032
OTHER EXPENSES				
Salaries and employee benefits	**5,604**	5,363	**11,029**	10,588
Net occupancy	**502**	521	**1,072**	1,124
Equipment	**761**	757	**1,472**	1,465
Other tax	**193**	236	**390**	397
Professional services	**198**	179	**453**	424
Supplies and postage	**122**	169	**313**	318
Marketing and corporate relations	**151**	127	**268**	205
FDIC and regulatory	**174**	162	**351**	329
Intangible assets amortization	**86**	85	**174**	167
Foreclosed real estate expenses	**39**	81	**40**	108
Other operating	**982**	861	**1,759**	1,640

Total Other Expenses		**8,812**		8,541		**17,321**		16,765
Income before Income Taxes		**4,029**		3,754		**7,399**		7,164
PROVISION FOR INCOME TAXES		**1,047**		944		**1,870**		1,811
Net Income	**$**	**2,982**	$	2,810	**$**	**5,529**	$	5,353
PER SHARE DATA								
Basic earnings	**$**	**0.49**	$	0.47	**$**	**0.91**	$	0.89
Cash dividends declared	**$**	**0.20**	$	0.20	**$**	**0.40**	$	0.40

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

Dollars in thousands	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
NET INCOME	**$ 2,982**	$ 2,810	**$ 5,529**	$ 5,353
OTHER COMPREHENSIVE INCOME				
SECURITIES				
Unrealized gains (losses) arising during the period, net of income taxes of $77, $(297), $423 and $(240), respectively	**153**	(573)	**823**	(463)
Reclassification adjustment for net gains included in net income, net of income taxes of $0, $(34), $0 and $(34), respectively (A) (C)		(67)		(67)
PENSION				
Amortization of pension net loss and prior service cost, net of income taxes of $58, $43, $116 and $86, respectively (B) (C)	**112**	83	**225**	166
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	**265**	(557)	**1,048**	(364)
TOTAL COMPREHENSIVE INCOME	**$ 3,247**	$ 2,253	**$ 6,577**	$ 4,989

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

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

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

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (UNAUDITED)

Six Months Ended June 30, 2016 and 2015

Dollars in thousands	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
BALANCE JANUARY 1, 2015	$ 15,196	$ (728)	$ 9,948	$ 88,329	$ (2,723)	$ 110,022
Net income				5,353		5,353
Other comprehensive loss, net of taxes					(364)	(364)
Common stock shares issued (14,458 shares)	36		261			297
Cash dividends declared				(2,407)		(2,407)
BALANCE JUNE 30, 2015	$ 15,232	$ (728)	$ 10,209	$ 91,275	$ (3,087)	$ 112,901
BALANCE JANUARY 1, 2016	**$ 15,256**	**$ (728)**	**$ 10,387**	**$ 94,526**	**$ (4,726)**	**$ 114,715**
Net income				**5,529**		**5,529**
Other comprehensive income, net of taxes					**1,048**	**1,048**
Common stock shares issued (9,647 shares)	**24**		**200**			**224**
Restricted stock grants (7,435 shares)	**19**		**100**			**119**
Restricted stock compensation expense			**59**			**59**
Cash dividends declared				**(2,417)**		**(2,417)**
BALANCE JUNE 30, 2016	**$ 15,299**	**$ (728)**	**$ 10,746**	**$ 97,638**	**$ (3,678)**	**$ 119,277**

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

ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Dollars in thousands	Six Months Ended June 30, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 5,529	$ 5,353
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sales of loans originated for sale	(296)	(223)
Gain on sales of foreclosed assets held for resale, including writedowns	(23)	(13)
Gain on sale of premises and equipment	(449)	
Earnings on investment in bank-owned life insurance	(558)	(547)
Gain on sales or calls of securities		(101)
Restricted stock compensation expense	59	
Depreciation and amortization	873	862
Provision for loan losses		
Net amortization of investment securities premiums	263	351
Decrease (increase) in accrued interest receivable	144	(113)
(Decrease) increase in accrued interest payable	(50)	15
Mortgage loans originated for sale	(18,017)	(14,159)
Proceeds from sales of loans originated for sale	19,193	15,089
(Increase) decrease in other assets	(467)	1,357
Increase (decrease) in other liabilities	912	(57)
Net Cash Provided by Operating Activities	7,113	7,814
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturities of investment securities held to maturity	11,732	5,469
Proceeds from maturities of investment securities available for sale	14,323	13,419
Proceeds from sales of investment securities available for sale		1,606
Purchase of investment securities available for sale	(4,052)	(5,118)
Purchase of investment securities held to maturity		(8,044)
Redemption of restricted investment in bank stocks	63	158
Net increase in loans	(14,321)	(19,457)
Purchase of book of business		(174)
Capital expenditures	(1,699)	(646)
Proceeds from sales of premises and equipment	1,929	
Proceeds from sales of foreclosed real estate	212	1,549
Net Cash Provided by (Used in) Investing Activities	8,187	(11,238)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits	11,142	12,575
Net (decrease) increase in time certificates of deposits and interest bearing deposits	(1,895)	14,718
Net increase (decrease) in short-term borrowings	988	(11,297)
Proceeds from long-term borrowings	9,000	4,000
Repayments on long-term borrowings	(5,000)	(6,138)
Dividends paid	(2,417)	(2,407)
Common stock issued	343	297
Net Cash Provided by Financing Activities	12,161	11,748
Net Increase in Cash and Cash Equivalents	27,461	8,324

CASH AND CASH EQUIVALENTS BEGINNING		**18,757**		19,673
CASH AND CASH EQUIVALENTS ENDING	**$**	**46,218**	$	27,997
Interest paid	**$**	**1,987**	$	1,944
Income taxes paid	**$**	**2,000**	$	675
Loans transferred to foreclosed assets held for resale and other foreclosed transactions	**$**	**338**	$	1,423

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

ACNB CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

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

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

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

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

The accounting policies followed by the Corporation are set forth in Note A to the Corporation s consolidated financial statements in the 2015 ACNB Corporation Annual Report on Form 10-K, filed with the SEC on March 4, 2016. It is suggested that the consolidated financial statements contained herein be read in conjunction with the consolidated financial statements and notes included in the Corporation s Annual Report on Form 10-K. The results of operations for the three and six month periods ended June 30, 2016, are not necessarily indicative of the results to be expected for the full year. Fixed assets held for sale is measured at the lower of its carrying amount or fair value less cost to sell.

The Corporation has evaluated events and transactions occurring subsequent to the statement of condition date of June 30, 2016, for items that should potentially be recognized or disclosed in the consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

2. Earnings Per Share and Restricted Stock Plan

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 6,043,522 and 6,019,148 weighted average shares of common stock outstanding for the six months ended June 30, 2016 and 2015, respectively, and 6,046,489 and 6,021,812 for the three months ended June 30, 2016 and 2015, respectively. All outstanding unvested restricted stock awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation.

The Corporation has a Restricted Stock plan available to selected officers and employees of the Bank to advance the best interest of the Corporation and its shareholders. The plan provides those persons who have responsibility for its growth with additional incentive by allowing them to acquire ownership in the Corporation and thereby encouraging them to contribute to the success of the Corporation. In June 2016, 7,435 shares were issued under this plan, which resulted in $59,000 of compensation expense. Of the 7,435 shares issued under the plan, 2,478 shares are fully vested and 4,957 will vest over the next two years.

3. **Retirement Benefits**

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

In thousands	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30 2016	Six Months Ended June 30 2015
Service cost	**$ 199**	$ 220	**$ 398**	$ 440
Interest cost	**284**	260	**568**	520
Expected return on plan assets	**(607)**	(635)	**(1,215)**	(1,270)
Amortization of net loss	**170**	120	**341**	240
Amortization of prior service cost		6		12
Net Periodic Benefit Expense (Income)	**$ 46**	$ (29)	**$ 92**	$ (58)

The Corporation previously disclosed in its consolidated financial statements for the year ended December 31, 2015, that it had not yet determined the amount the Bank planned on contributing to the defined benefit plan in 2016. As of June 30, 2016, this contribution amount had still not been determined. Effective April 1, 2012, no inactive or former participant in the plan is eligible to again participate in the plan, and no employee hired after March 31, 2012, is eligible to participate in the plan. As of the last annual census, ACNB Bank had a combined 375 active, vested, terminated and retired persons in the plan.

4. **Guarantees**

The Corporation does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Corporation generally holds collateral and/or personal guarantees supporting these commitments. The Corporation had $5,691,000 in standby letters of credit as of June 30, 2016. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability, as of June 30, 2016, for guarantees under standby letters of credit issued is not material.

5. **Accumulated Other Comprehensive Loss**

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

In thousands	Unrealized Gains on Securities	Pension Liability	Accumulated Other Comprehensive Loss
BALANCE JUNE 30, 2016	**$ 1,987**	**$ (5,665)**	**$ (3,678)**

BALANCE	DECEMBER 31, 2015	$	1,164	$	(5,890)	$	(4,726)
BALANCE	JUNE 30, 2015	$	2,040	$	(5,127)	$	(3,087)

6. **Segment Reporting**

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

Segment information for the six month periods ended June 30, 2016 and 2015, is as follows:

In thousands		Banking		Insurance		Total
2016						
Net interest income and other income from external customers	**$**	**22,289**	**$**	**2,431**	**$**	**24,720**
Income before income taxes		**6,939**		**460**		**7,399**
Total assets		**1,159,662**		**9,448**		**1,169,110**
Capital expenditures		**1,687**		**12**		**1,699**
2015						
Net interest income and other income from external customers	$	21,644	$	2,285	$	23,929
Income before income taxes		6,797		367		7,164
Total assets		1,096,404		9,847		1,106,251
Capital expenditures		626		20		646

Segment information for the three month periods ended June 30, 2016 and 2015, is as follows:

In thousands		Banking		Insurance		Total
2016						
Net interest income and other income from external customers	**$**	**11,513**	**$**	**1,328**	**$**	**12,841**
Income before income taxes		**3,720**		**309**		**4,029**
Total assets		**1,159,662**		**9,448**		**1,169,110**
Capital expenditures		**924**				**924**
2015						
Net interest income and other income from external customers	$	11,068	$	1,227	$	12,295
Income before income taxes		3,497		257		3,754
Total assets		1,096,404		9,847		1,106,251
Capital expenditures		337		20		357

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

7. Securities

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

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

Amortized cost and fair value of securities at June 30, 2016, and December 31, 2015, were as follows:

In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
JUNE 30, 2016				
U.S. Government and agencies	**$ 45,291**	**$ 772**	**$**	**$ 46,063**
Mortgage-backed securities, residential	**36,363**	**1,637**		**38,000**
State and municipal	**23,591**	**571**		**24,162**
Corporate bonds	**7,000**	**5**	**15**	**6,990**
CRA mutual fund	**1,044**	**29**		**1,073**
Stock in other banks	**702**	**35**	**24**	**713**
	$ 113,991	**$ 3,049**	**$ 39**	**$ 117,001**
DECEMBER 31, 2015				
U.S. Government and agencies	$ 46,218	$ 124	$ 313	$ 46,029
Mortgage-backed securities, residential	41,528	1,336	25	42,839
State and municipal	27,437	642	1	28,078
Corporate bonds	7,000	20	65	6,955
CRA mutual fund	1,044	9		1,053
Stock in other banks	702	49	12	739
	$ 123,929	$ 2,180	$ 416	$ 125,693
SECURITIES HELD TO MATURITY				
JUNE 30, 2016				
U.S. Government and agencies	**$ 23,024**	**$ 285**	**$**	**$ 23,309**
Mortgage-backed securities, residential	**36,657**	**931**		**37,588**
	$ 59,681	**$ 1,216**	**$**	**$ 60,897**
DECEMBER 31, 2015				
U.S. Government and agencies	$ 31,044	$ 27	$ 176	$ 30,895
Mortgage-backed securities, residential	40,498	232	262	40,468
	$ 71,542	$ 259	$ 438	$ 71,363

The following table shows the Corporation s investments gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2016, and December 31, 2015:

	Less than 12 Months				12 Months or More				Total			
In thousands		Fair Value		Unrealized Losses		Fair Value		Unrealized Losses		Fair Value		Unrealized Losses
SECURITIES AVAILABLE FOR SALE												
JUNE 30, 2016												
Corporate bond	**$**	**4,985**	**$**	**15**	**$**		**$**		**$**	**4,985**	**$**	**15**
Stock in other banks		**180**		**24**						**180**		**24**
	$	**5,165**	**$**	**39**	**$**		**$**		**$**	**5,165**	**$**	**39**
DECEMBER 31, 2015												
U.S. Government and agencies	$	31,992	$	313	$		$		$	31,992	$	313
Mortgage-backed securities, residential		4,855		25						4,855		25
State and municipal		909		1						909		1
Corporate bond		4,935		65						4,935		65
Stock in other banks		191		12						191		12
	$	42,882	$	416	$		$		$	42,882	$	416
SECURITIES HELD TO MATURITY												
DECEMBER 31, 2015												
U.S. Government and agencies	$	18,959	$	83	$	6,907	$	93	$	25,866	$	176
Mortgage-backed securities, residential		3,109		13		15,420		249		18,529		262
	$	22,068	$	96	$	22,327	$	342	$	44,395	$	438

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

At June 30, 2016, one available for sale corporate bond 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 June 30, 2016, one available for sale stock in other banks had an unrealized loss that did not exceed 12% of amortized cost. This security has not been in a continuous loss position for 12 months or more. This unrealized loss relates principally to daily market changes.

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

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

Management routinely sells securities from its available for sale portfolio in an effort to manage and allocate the portfolio. At June 30, 2016, management had not identified any securities with an unrealized loss that it intends to sell or will be required to sell. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the security, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of unrealized losses.

Amortized cost and fair value at June 30, 2016, by contractual maturity, where applicable, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	Available for Sale		Held to Maturity	
In thousands	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
1 year or less	**$ 10,117**	**$ 10,194**	**$ 1,993**	**$ 1,998**
Over 1 year through 5 years	**48,318**	**49,298**	**21,031**	**21,311**
Over 5 years through 10 years	**17,447**	**17,723**		
Over 10 years				
Mortgage-backed securities, residential	**36,363**	**38,000**	**36,657**	**37,588**
CRA mutual fund	**1,044**	**1,073**		
Stock in other banks	**702**	**713**		
	$ 113,991	**$ 117,001**	**$ 59,681**	**$ 60,897**

The Corporation did not realize any gross gains or losses on sales of securities available for sale during the three and six months ended June 30, 2016. The Corporation realized $101,000 gross gains and $0 gross losses on sales of securities available for sale during the three and six month periods ended June 30, 2015.

At June 30, 2016, and December 31, 2015, securities with a carrying value of $117,170,000 and $117,646,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements, and for other purposes.

8. Loans

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

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

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

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

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

Allowance for Credit Losses

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Consumer Lending The Corporation offers a variety of secured and unsecured consumer loans, including those for vehicles and mobile homes and 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 is determined by the borrower s employment history, current financial condition, and credit background.

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

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard, and doubtful within the Corporation s internal risk rating system as of June 30, 2016, and December 31, 2015:

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
JUNE 30, 2016					
Commercial and industrial	**$ 115,954**	**$ 3,939**	**$ 2,074**	**$**	**$ 121,967**
Commercial real estate	**271,956**	**21,812**	**11,368**		**305,136**
Commercial real estate construction	**9,144**	**1,661**	**299**		**11,104**
Residential mortgage	**343,833**	**5,219**	**895**		**349,947**
Home equity lines of credit	**63,061**	**988**	**128**		**64,177**
Consumer	**14,501**				**14,501**
	$ 818,449	**$ 33,619**	**$ 14,764**	**$**	**$ 866,832**
DECEMBER 31, 2015					
Commercial and industrial	$ 112,037	$ 3,744	$ 1,911	$	$ 117,692
Commercial real estate	252,071	23,421	14,407		289,899
Commercial real estate construction	11,087	1,968	374		13,429
Residential mortgage	350,537	5,548	1,143		357,228
Home equity lines of credit	58,856	1,138	130		60,124
Consumer	14,588				14,588
	$ 799,176	$ 35,819	$ 17,965	$	$ 852,960

The following table summarizes information relative to impaired loans by loan portfolio class as of June 30, 2016, and December 31, 2015:

	Impaired Loans with Allowance			Impaired Loans with No Allowance	
In thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
JUNE 30, 2016					
Commercial and industrial	**$**	**$**	**$**	**$ 1,473**	**$ 1,473**
Commercial real estate				**8,270**	**8,469**
Commercial real estate construction				**300**	**300**
Residential mortgage	**372**	**372**	**164**	**446**	**446**
	$ 372	**$ 372**	**$ 164**	**$ 10,489**	**$ 10,688**
DECEMBER 31, 2015					
Commercial and industrial	$	$	$	$ 1,471	$ 1,471
Commercial real estate				8,185	8,396
Commercial real estate construction				374	648
Residential mortgage				461	461
	$	$	$	$ 10,491	$ 10,976

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the three months ended June 30, 2016 and 2015:

	Impaired Loans with Allowance				Impaired Loans with No Allowance			
In thousands		**Average Recorded Investment**		**Interest Income**		**Average Recorded Investment**		**Interest Income**
JUNE 30, 2016								
Commercial and industrial	**$**		**$**		**$**	**1,440**	**$**	
Commercial real estate						**8,446**		**105**
Commercial real estate construction						**337**		
Residential mortgage		**186**				**448**		**4**
	$	**186**	**$**		**$**	**10,671**	**$**	**109**
JUNE 30, 2015								
Commercial and industrial	$		$		$	1,620	$	129
Commercial real estate						9,424		214
Commercial real estate construction						261		
Residential mortgage		347				312		
	$	347	$		$	11,617	$	343

The following table summarizes information in regards to the average of impaired loans and related interest income by loan portfolio class for the six months ended June 30, 2016 and 2015:

	Impaired Loans with Allowance				Impaired Loans with No Allowance			
In thousands		**Average Recorded Investment**		**Interest Income**		**Average Recorded Investment**		**Interest Income**
JUNE 30, 2016								
Commercial and industrial	**$**		**$**		**$**	**1,451**	**$**	
Commercial real estate						**8,359**		**223**
Commercial real estate construction						**349**		
Residential mortgage		**124**				**452**		**9**
	$	**124**	**$**		**$**	**10,611**	**$**	**232**
JUNE 30, 2015								
Commercial and industrial	$		$		$	1,657	$	129
Commercial real estate						9,615		271
Commercial real estate construction						297		
Residential mortgage		463				483		5
	$	463	$		$	12,052	$	405

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

The following table presents nonaccrual loans by loan portfolio class as of June 30, 2016, and December 31, 2015:

In thousands		June 30, 2016		December 31, 2015
Commercial and industrial	$	**1,473**	$	1,471
Commercial real estate		**1,844**		1,676
Commercial real estate construction		**300**		374
Residential mortgage		**541**		178
	$	**4,158**	$	3,699

The following table summarizes information relative to troubled debt restructurings by loan portfolio class as of June 30, 2016, and December 31, 2015:

In thousands		Pre-Modification Outstanding Recorded Investment		Post-Modification Outstanding Recorded Investment		Recorded Investment at Period End
JUNE 30, 2016						
Nonaccruing troubled debt restructurings:						
Commercial real estate	$	**1,021**	$	**1,021**	$	**417**
Commercial real estate construction		**1,548**		**1,541**		
Total nonaccruing troubled debt restructurings		**2,569**		**2,562**		**417**
Accruing troubled debt restructurings:						
Commercial real estate		**7,118**		**7,170**		**6,426**
Residential mortgage		**336**		**336**		**277**
Total accruing troubled debt restructurings		**7,454**		**7,506**		**6,703**
Total Troubled Debt Restructurings	$	**10,023**	$	**10,068**	$	**7,120**
DECEMBER 31, 2015						
Nonaccruing troubled debt restructurings:						
Commercial real estate	$	1,021	$	1,021	$	460
Commercial real estate construction		1,548		1,541		74
Total nonaccruing troubled debt restructurings		2,569		2,562		534
Accruing troubled debt restructurings:						
Commercial real estate		7,118		7,170		6,509
Residential mortgage		336		336		283
Total accruing troubled debt restructurings		7,454		7,506		6,792
Total Troubled Debt Restructurings	$	10,023	$	10,068	$	7,326

All of the Corporation s troubled debt restructured loans are also impaired loans, of which some have resulted in a specific allocation and, subsequently, a charge-off as appropriate. As of June 30, 2016 and 2015, there were no defaulted troubled debt restructured loans. There were no charge-offs or specific allocation on any of the troubled debt restructured loans for the three and six months ended June 30, 2016 and 2015. One troubled debt restructured loan paid off during 2016 in the amount of $74,000. One troubled debt restructured loan paid off during 2015 in the amount of $70,000. All other troubled debt restructured loans were current as of June 30, 2016, with respect to their associated forbearance agreement, except for one loan which has had periodic late payments. One forbearance agreement was negotiated during 2010, three were negotiated during 2012, and one was negotiated during 2013.

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

There were no loans whose terms have been modified resulting in troubled debt restructurings during the three and six months ended June 30, 2016 and 2015.

Consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process at June 30, 2016 and December 31, 2015, totaled $892,000 and $583,000, respectively.

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

The following table presents the classes of the loan portfolio summarized by the past due status as of June 30, 2016, and December 31, 2015:

In thousands	30-59 Days Past Due	60-89 Days Past Due	>90 Days Past Due	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
JUNE 30, 2016							
Commercial and industrial	**$ 12**	**$**	**$ 1,258**	**$ 1,270**	**$ 120,697**	**$ 121,967**	**$**
Commercial real estate		**593**	**417**	**1,010**	**304,126**	**305,136**	
Commercial real estate construction			**300**	**300**	**10,804**	**11,104**	
Residential mortgage	**330**	**905**	**1,966**	**3,201**	**346,746**	**349,947**	**1,433**
Home equity lines of credit	**134**	**42**	**201**	**377**	**63,800**	**64,177**	**201**
Consumer	**43**	**18**		**61**	**14,440**	**14,501**	
	$ 519	**$ 1,558**	**$ 4,142**	**$ 6,219**	**$ 860,613**	**$ 866,832**	**$ 1,634**
DECEMBER 31, 2015							
Commercial and industrial	$ 16	$ 61	$ 1,471	$ 1,548	$ 116,144	$ 117,692	$
Commercial real estate	77	1,047	743	1,867	288,032	289,899	
Commercial real estate construction			374	374	13,055	13,429	
Residential mortgage	1,686	248	2,082	4,016	353,212	357,228	1,904
Home equity lines of credit	186		228	414	59,710	60,124	228
Consumer	26	26		52	14,536	14,588	
	$ 1,991	$ 1,382	$ 4,898	$ 8,271	$ 844,689	$ 852,960	$ 2,132

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

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF AND FOR THE PERIOD ENDED JUNE 30, 2016								
Allowance for Loan Losses								
Beginning balance - April 1, 2016	$ 2,693	$ 5,565	$ 114	$ 3,291	$ 617	$ 1,050	$ 1,210	$ 14,540
Charge-offs	(26)					(9)		(35)
Recoveries	34		91	3		3		131
Provisions	(144)	(132)	(71)	17	(10)	(92)	432	
Ending balance - June 30, 2016	$ 2,557	$ 5,433	$ 134	$ 3,311	$ 607	$ 952	$ 1,642	$ 14,636
Beginning balance - January 1, 2016	$ 2,508	$ 5,216	$ 112	$ 3,349	$ 619	$ 1,083	$ 1,860	$ 14,747
Charge-offs	(90)		(135)	(39)	(9)	(22)		(295)
Recoveries	39		132	6		7		184
Provisions	100	217	25	(5)	(3)	(116)	(218)	
Ending balance - June 30, 2016	$ 2,557	$ 5,433	$ 134	$ 3,311	$ 607	$ 952	$ 1,642	$ 14,636
Ending balance: individually evaluated for impairment	$	$	$	$ 164	$	$	$	$ 164
Ending balance: collectively evaluated for impairment	$ 2,557	$ 5,433	$ 134	$ 3,147	$ 607	$ 952	$ 1,642	$ 14,472
Loans Receivable								
Ending balance	$ 121,967	$ 305,136	$ 11,104	$ 349,947	$ 64,177	$ 14,501	$	$ 866,832
Ending balance: individually evaluated for impairment	$ 1,473	$ 8,270	$ 300	$ 818	$	$	$	$ 10,861
Ending balance: collectively evaluated for impairment	$ 120,494	$ 296,866	$ 10,804	$ 349,129	$ 64,177	$ 14,501	$	$ 855,971
AS OF AND FOR THE PERIOD ENDED JUNE 30, 2015								
Allowance for Loan Losses								
Beginning Balance - April 1, 2015	$ 2,170	$ 5,500	$ 168	$ 3,591	$ 537	$ 1,030	$ 2,069	$ 15,065
Charge-offs	(37)		(39)	(428)	(15)	(26)		(545)
Recoveries	340			2		3		345
Provisions	(209)	(346)	26	196	50	83	200	
Ending balance - June 30, 2015	$ 2,264	$ 5,154	$ 155	$ 3,361	$ 572	$ 1,090	$ 2,269	$ 14,865
Beginning Balance - January 1, 2015	$ 2,048	$ 5,872	$ 194	$ 3,845	$ 557	$ 1,050	$ 1,606	$ 15,172
Charge-offs	(73)		(39)	(504)	(15)	(47)		(678)
Recoveries	363			4		4		371
Provisions	(74)	(718)		16	30	83	663	
Ending balance - June 30, 2015	$ 2,264	$ 5,154	$ 155	$ 3,361	$ 572	$ 1,090	$ 2,269	$ 14,865
Ending balance: individually evaluated for impairment	$	$	$	$	$	$	$	$
Ending balance: collectively evaluated for impairment	$ 2,264	$ 5,154	$ 155	$ 3,361	$ 572	$ 1,090	$ 2,269	$ 14,865
Loans Receivable								
Ending balance	$ 95,974	$ 279,390	$ 15,665	$ 354,433	$ 56,868	$ 14,669	$	$ 816,999
	$ 1,582	$ 8,964	$ 194	$ 310	$	$	$	$ 11,050

Ending balance: individually evaluated for impairment																
Ending balance: collectively evaluated for impairment	$	94,392	$	270,426	$	15,471	$	354,123	$	56,868	$	14,669	$		$	805,949

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
AS OF DECEMBER 31, 2015								
Allowance for Loan Losses								
Ending balance	$ 2,508	$ 5,216	$ 112	$ 3,349	$ 619	$ 1,083	$ 1,860	$ 14,747
Ending balance: individually evaluated for impairment	$	$	$	$	$	$	$	$
Ending balance: collectively evaluated for impairment	$ 2,508	$ 5,216	$ 112	$ 3,349	$ 619	$ 1,083	$ 1,860	$ 14,747
Loans Receivable								
Ending balance	$ 117,692	$ 289,899	$ 13,429	$ 357,228	$ 60,124	$ 14,588	$	$ 852,960
Ending balance: individually evaluated for impairment	$ 1,471	$ 8,185	$ 374	$ 461	$	$	$	$ 10,491
Ending balance: collectively evaluated for impairment	$ 116,221	$ 281,714	$ 13,055	$ 356,767	$ 60,124	$ 14,588	$	$ 842,469

9. Fair Value Measurements

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

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

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

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

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

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

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

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

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

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis of measurement used, at June 30, 2016, and December 31, 2015, are as follows:

		June 30, 2016			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		**$ 46,063**	**$**	**$ 46,063**	**$**
Mortgage-backed securities, residential		**38,000**		**38,000**	
State and municipal		**24,162**		**24,162**	
Corporate bonds		**6,990**		**6,990**	
CRA mutual fund		**1,073**	**1,073**		
Stock in other banks		**713**	**713**		
Total securities available for sale	**Recurring**	**$ 117,001**	**$ 1,786**	**$ 115,215**	**$**
Impaired loans	**Nonrecurring**	**$ 4,280**	**$**	**$**	**$ 4,280**

		December 31, 2015			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		$ 46,029	$	$ 46,029	$
Mortgage-backed securities, residential		42,839		42,839	
State and municipal		28,078		28,078	
Corporate bonds		6,955		6,955	
CRA mutual fund		1,053	1,053		
Stock in other banks		739	739		
Total securities available for sale	Recurring	$ 125,693	$ 1,792	$ 123,901	$
Impaired loans	Nonrecurring	$ 4,451	$	$	$ 4,451

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

	Quantitative Information about Level 3 Fair Value Measurements				
Dollars in thousands	**Fair Value Estimate**	**Valuation Technique**	**Unobservable Input**	**Range**	**Weighted Average**
June 30, 2016					
Impaired loans	**$ 4,280**	**Appraisal of collateral (a)**	**Appraisal adjustments (b)**	**(10) - (50)%**	**(22)%**
December 31, 2015					
Impaired loans	$ 4,451	Appraisal of collateral (a)	Appraisal adjustments (b)	(10) - (50)%	(16)%

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

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

The following information should not be interpreted as an estimate of the fair value of the entire Corporation since a fair value calculation is only provided for a limited portion of the Corporation s assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Corporation s disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of certain Corporation financial instruments at June 30, 2016, and December 31, 2015:

Cash and Cash Equivalents (Carried at Cost)

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

Securities

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

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

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

Loans (Carried at Cost)

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

Impaired Loans (Generally Carried at Fair Value)

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

Foreclosed Assets Held for Resale

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

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

Restricted Investment in Bank Stock (Carried at Cost)

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

Accrued Interest Receivable and Payable (Carried at Cost)

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

Deposits (Carried at Cost)

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

Short-Term Borrowings (Carried at Cost)

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

Long-Term Borrowings (Carried at Cost)

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

Off-Balance Sheet Credit-Related Instruments

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

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Corporation s financial instruments as of June 30, 2016, and December 31, 2015:

		June 30, 2016		
In thousands	**Fair Value**	**Level 1**	**Level 2**	**Level 3**

	Carrying Amount				
Financial assets:					
Cash and due from banks	$ 14,299	$ 14,299	$ 7,667	$ 6,632	$
Interest-bearing deposits in banks	31,919	31,919	31,919		
Investment securities available for sale	117,001	117,001	1,786	115,215	
Investment securities held to maturity	59,861	60,897		60,897	
Loans held for sale	955	955		955	
Loans, less allowance for loan losses	852,196	870,512			870,512
Accrued interest receivable	2,872	2,872		2,872	
Restricted investment in bank stocks	4,351	4,351		4,351	
Financial liabilities:					
Deposits	922,227	922,859		922,859	
Short-term borrowings	36,190	36,190		36,190	
Long-term borrowings	80,500	81,814		81,814	
Accrued interest payable	765	765		765	
Off-balance sheet financial instruments					

	December 31, 2015				
In thousands	**Carrying Amount**	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets:					
Cash and due from banks	$ 13,468	$ 13,468	$ 6,746	$ 6,722	$
Interest-bearing deposits in banks	5,289	5,289	5,289		
Investment securities available for sale	125,693	125,693	1,792	123,901	
Investment securities held to maturity	71,542	71,363		71,363	
Loans held for sale	1,835	1,835		1,835	
Loans, less allowance for loan losses	838,213	842,169			842,169
Accrued interest receivable	3,016	3,016		3,016	
Restricted investment in bank stocks	4,414	4,414		4,414	
Financial liabilities:					
Deposits	912,980	913,188		913,188	
Short-term borrowings	35,202	35,202		35,202	
Long-term borrowings	76,500	77,545		77,545	
Accrued interest payable	815	815		815	
Off-balance sheet financial instruments					

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

The Corporation enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Corporation may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Corporation to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing agreements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Corporation s consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Corporation does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

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

The following table presents the short-term borrowings subject to an enforceable master netting arrangement or repurchase agreement as of June 30, 2016, and December 31, 2015:

In thousands		Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition: Financial Instruments	Gross Amounts Not Offset in the Statements of Condition: Cash Collateral Pledged	Net Amount
June 30, 2016							
Repurchase agreements							
Commercial customers and government entities	(a)	**$ 36,190**	**$**	**$ 36,190**	**$ (36,190)**	**$**	**$**
December 31, 2015							
Repurchase agreements							
Commercial customers and government entities	(a)	$ 35,202	$	$ 35,202	$ (35,202)	$	$

(a) As of June 30, 2016, and December 31, 2015, the fair value of securities pledged in connection with repurchase agreements was $44,090,000 and $41,132,000, respectively.

The following table presents the remaining contractual maturity of the master netting arrangement or repurchase agreements as of June 30, 2016:

	Remaining Contractual Maturity of the Agreements				
In thousands	**Overnight and Continuous**	**Up to 30 Days**	**30 - 90 Days**	**Greater than 90 Days**	**Total**
Repurchase agreements and repurchase-to-maturity transactions					
U.S. Treasury and agency securities	**$ 36,190**	**$**	**$**	**$**	**$ 36,190**
Total	**$ 36,190**	**$**	**$**	**$**	**$ 36,190**

11. New Accounting Pronouncements

ASU 2014-09, 2015-14, 2016-08 and 2016-12

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606).*

The amendments in this Update establish a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. The revenue standard s core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation.

The amendments in this Update were originally effective for public entities for annual periods beginning after December 15, 2016, including interim periods therein. Three basic transition methods are available full retrospective, retrospective with certain practical expedients, and a cumulative effect approach. Under the third alternative, an entity would apply the new revenue standard only to contracts that are incomplete under legacy U.S. GAAP at the date of initial application and recognize the cumulative effect of the new standard as an adjustment to the opening balance of retained earnings. That is, prior years would not be restated and additional disclosures would be required to enable users of the financial statements to understand the impact of adopting the new standard in the current year compared to prior years that are presented under legacy U.S. GAAP. Early adoption is prohibited under U.S. GAAP.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606).

ASU 2015-14 defers the effective date of the new revenue recognition standard by one year. As such, it now takes effect for public entities in fiscal years beginning after December 15, 2017. All other entities have an additional year. However, early adoption is permitted for any entity that chooses to adopt the new standard as of the original effective date.

Public business entities will adopt the standard for annual reporting periods beginning after December 15, 2017, including interim periods within that year. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that year.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)

ASU 2016-08 updates the new revenue standard by clarifying the principal versus agent implementation guidance, but does not change the core principle of the new standard. The updates to the principal versus agent guidance:

- require an entity to determine whether it is a principal or an agent for each distinct good or service (or a distinct bundle of goods or services) to be provided to the customer;

- illustrate how an entity that is a principal might apply the control principle to goods, services, or rights to services, when another party is involved in providing goods or services to a customer;

- clarify that the purpose of certain specific control indicators is to support or assist in the assessment of whether an entity controls a good or service before it is transferred to the customer, provide more specific guidance on how the indicators should be considered, and clarify that their relevance will vary depending on the facts and circumstances; and

- revise existing examples and add two new ones to more clearly depict how the guidance should be applied.

In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients.*

The amendments do not alter the core principle of the new revenue standard, but make certain targeted changes to clarify the following:

- *Assessing collectibility* - The amendments add a substantially all threshold to the collectibility criterion, and also clarify that the objective of the collectibility assessment is to determine whether the contract is valid and represents a substantive transaction based on whether a customer has the ability and intent to pay for the goods or services that will be transferred to the customer, as opposed to all of the goods or services promised in the contract. The ASU also clarifies how an entity may recognize as revenue consideration received in circumstances where a contract does not meet the criteria required at inception to apply the recognition guidance within the revenue standard.

- *Presenting sales taxes and other similar taxes collected from customers* - The amendments provide an accounting policy election whereby an entity may exclude from the measurement of transaction price all taxes assessed by a taxing authority related to the specific transaction and which are collected from the customer. Such amounts would be presented net under this option.

- *Noncash consideration* - The amendments clarify that the fair value of noncash consideration is measured at contract inception, and specify how to account for subsequent changes in the fair value of noncash consideration.

- *Contract modifications at transition* - The amendments provide a new practical expedient whereby an entity electing either the full or modified retrospective method of transition is permitted to reflect the aggregate effect of all prior period modifications (using hindsight) when identifying satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price to satisfied and unsatisfied obligations.

- *Completed contracts at transition* - The amendments include certain practical expedients in transition related to completed contracts. The amendments also clarify the definition of a completed contract.

- *Disclosing the accounting change in the period of adoption* - ASU 2016-12 provides an exception to the requirement in Topic 250 to disclose the effect on the current period of retrospectively adopting a new accounting standard.

The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements of Topic 606.

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

ASU 2016-01

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments Overall (Topic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.*

ASU 2016-01 amends the guidance on the classification and measurement of financial instruments. Some of the amendments in ASU 2016-01 include the following among others: (i) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and, (iv) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value.

For public business entities, the amendments of ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years.

The Corporation is currently evaluating the impact ASU 2016-01 will have on its consolidated financial condition or results of operations.

ASU 2016-02

In February 2016, the FASB issued ASU 2016-02, *Leases*.

From the lessee s perspective, the new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for a lessee. From the lessor s perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing lease. If the lessor doesn t convey risks and rewards or control, an operating lease results.

The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. A modified retrospective transition approach is required for lessors for sales-type, direct financing, and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available.

The Corporation is currently evaluating the impact ASU 2016-02 will have on its consolidated financial condition or results of operations.

ASU 2016-09

In March 2016, the FASB issued ASU 2016-09, *Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*.

ASU 2016-09 introduces targeted amendments intended to simplify the accounting for stock compensation. Specifically, the ASU requires all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) to be recognized as income tax expense or benefit in the income statement. The tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity also should recognize excess tax benefits, and assess the need for a valuation allowance, regardless of whether the benefit reduces taxes payable in the current period. That is, off balance sheet accounting for net operating losses stemming from excess tax benefits would no longer be required and instead such net operating losses would be recognized when they arise. Existing net operating losses that are currently tracked off balance sheet would be recognized, net of a valuation allowance if required, through an adjustment to opening retained earnings in the period of adoption. Entities will no longer need to maintain and track an APIC pool. The ASU also requires excess tax benefits to be classified along with other income tax cash flows as an operating activity in the statement of cash flows.

In addition, the ASU elevates the statutory tax withholding threshold to qualify for equity classification up to the maximum statutory tax rates in the applicable jurisdiction(s). The ASU also clarifies that cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity.

The ASU provides an optional accounting policy election (with limited exceptions), to be applied on an entity-wide basis, to either estimate the number of awards that are expected to vest (consistent with existing U.S. GAAP) or account for forfeitures when they occur.

The amendments are effective for public business entities for annual periods beginning after December 15, 2016, and interim periods within those annual periods.

The Corporation does not expect this ASU 2016-09 will have a material effect on its consolidated financial condition or results of operations.

ASU 2016-13

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.*

ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination (PCD assets), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price (gross up approach) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.

Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis.

Certain incremental disclosures are required.

The new standard is effective for fiscal year beginning after December 15, 2018, including interim periods within the fiscal year. For public business entities that are SEC filers, the amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted.

The Corporation is currently evaluating the impact ASU 2016-13 will have on its consolidated financial condition or results of operations.

ACNB CORPORATION

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

INTRODUCTION AND FORWARD-LOOKING STATEMENTS

Introduction

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

Forward-Looking Statements

In addition to historical information, this Form 10-Q contains forward-looking statements. Examples of forward-looking statements include, but are not limited to, (a) projections or statements regarding future earnings, expenses, net interest income, other income, earnings or loss per share, asset mix and quality, growth prospects, capital structure, and other financial terms, (b) statements of plans and objectives of management or the Board of Directors, and (c) statements of assumptions, such as economic conditions in the Corporation s market areas. Such forward-looking statements can be identified by the use of forward-looking terminology such as believes , expects , may , intends , will , should , anticipates negative of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy. Forward-looking statements are subject to certain risks and uncertainties such as local economic conditions, competitive factors, and regulatory limitations. Actual results may differ materially from those projected in the forward-looking statements. Such risks, uncertainties and other factors that could cause actual results and experience to differ from those projected include, but are not limited to, the following: the effects of economic deterioration and the prolonged economic malaise on current customers, specifically the effect of the economy on loan customers ability to repay loans; the effects of governmental and fiscal policies, as well as legislative and regulatory changes; the effects of new laws and regulations, specifically the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act; impacts of the new capital and liquidity requirements of the Basel III standards; the effects of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters; ineffectiveness of the business strategy due to changes in current or future market conditions; future actions or inactions of the United States government, including the effects of short- and long-term federal budget and tax negotiations and a failure to increase the government debt limit or a prolonged shutdown of the federal government; the effects of competition, and of changes in laws and regulations on competition, including industry consolidation and development of competing financial products and services; the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities, and interest rate protection agreements, as well as interest rate risks; difficulties in acquisitions and integrating and operating acquired business operations, including information technology difficulties; challenges in establishing and maintaining operations in new markets; the effects of technology changes; volatilities in the securities markets; slow economic conditions; the failure of assumptions underlying the establishment of reserves for loan losses and estimations of values of collateral and various financial assets and liabilities; acts of war or terrorism; disruption of credit and equity markets; the ability to manage current levels of impaired assets; the loss of certain key officers; the ability to maintain the value and image of ACNB s brand and protect ACNB s intellectual property rights; continued relationships with major customers; and, potential impacts to ACNB from continually evolving cybersecurity and other technological risks and attacks, including additional costs, reputational damage, regulatory penalties, and financial losses. We caution readers not to place undue reliance on these forward-looking statements. They only reflect management s analysis as of this date. The Corporation does not revise or update these forward-looking statements to reflect events or changed circumstances. Please carefully review the risk factors described in other documents the Corporation files from time to time with the Securities and Exchange Commission, including the Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and any Current Reports on Form 8-K.

CRITICAL ACCOUNTING POLICIES

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

The allowance for loan losses represents management s estimate of probable losses inherent in the loan portfolio.

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

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

Accounting Standard Codification (ASC) Topic 350, *Intangibles Goodwill and Other*, requires that goodwill is not amortized to expense, but rather that it be assessed or tested for impairment at least annually. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. The Corporation did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of October 1, 2015. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested for impairment when such events occur. The Corporation has not identified any such events and, accordingly, has not tested goodwill for impairment during the six months ended June 30, 2016. Other acquired intangible assets with finite lives, such as customer lists, are required to be amortized over the estimated lives. These intangibles are generally amortized using the straight line method over estimated useful lives of ten years.

RESULTS OF OPERATIONS

Quarter ended June 30, 2016, compared to Quarter ended June 30, 2015

Executive Summary

Net income for the three months ended June 30, 2016, was $2,982,000, compared to $2,810,000 for the same quarter in 2015, an increase of $172,000 or 6.1%. Earnings per share was $0.49 in 2016 and $0.47 in 2015. Net interest income decreased $26,000, or 0.3%, as decreases in total interest income were more than decreases in total interest expense. Provision for loan losses was $0 in 2016, no change from the same quarter in 2015, based on the adequacy analysis of the allowance for loan losses calculation at the end of each period, resulting in an allowance to total loans of 1.69% at June 30, 2016. Other income increased $572,000, or 17.7%, due in part to a gain on sale of premises and equipment. Other expenses increased $271,000, or 3.2%, due in part to higher salary/benefits from a change to higher skilled and compensated staff and higher per employee benefit cost.

Net Interest Income

Net interest income totaled $9,030,000 for the quarter ended June 30, 2016, compared to $9,056,000 for the same period in 2015, a decrease of $26,000, or 0.3%. Net interest income decreased due to a decrease in interest income to a greater extent than a decrease in interest expense.

Interest income decreased $35,000, or 0.3%, due to paydowns in the investment portfolio that were not replaced at the current much lower yields due to interest rate risk; despite a 5.8% increase in average loan volume. The decrease in interest expense resulted from a change in funding mix to more lower cost market-based deposits and lower cost on long-term borrowings. Increased lending was a result of a concerted effort to offset the recent year trend of interest income decreases due to slow economic activity and declines in the U.S. Treasury yields and other market driver interest rates. These driver rates affect new loan originations and are indexed to a portion of the loan portfolio in that a decrease in the driver rates decreases the yield on new loans and on existing loans at subsequent interest rate reset dates. In this manner, interest income yield is negatively affected as new loans replace paydowns on existing loans and variable rate loans reset to new lower rates. Interest income was lower on investment securities as paydowns were not reinvested due to the continued low market rates, which were a result of uneven domestic and international economic conditions including the event referred to as the Brexit referendum that occurred in the second quarter of 2016. An appropriate amount of earning assets remained in short-term, low-rate money market type accounts during the second quarter of 2016; even with increased loan demand, there exists ample ability to borrow at low rates for liquidity needs. The ability to increase lending is contingent on the effects of intense competition that can reduce new loans and may result in the payoff of existing loans, as well as economic conditions in the Corporation s marketplace. As to funding costs, interest rates on alternative funding sources, such as the FHLB, and other market driver rates are factors in rates the Corporation and the local market pay for deposits. However, during the second quarter of 2016, several of the core deposit rates continued at practical floors after the Federal Open Market Committee (FOMC) decreased the Federal Funds Target Rate by 400 basis points during 2008 and has maintained it at 0% since that time. In mid-December 2015 the rate was increased to 0.25% - 0.50%. Interest expense decreased $9,000, or 0.9%, due to a change in the mix of funding to more lower cost market-based deposits. This trend is not expected to continue due to competing non-bank money market funding products that gained an advantage when the Federal Reserve FOMC raised short-term rates in mid December 2015. For more information about interest rate risk, please refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K for the fiscal year ended December 31, 2015, and filed with the SEC on March 4, 2016. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the second quarter of 2016 was 3.28% compared to 3.44% during the same period in 2015. Also comparing the second quarter of 2016 to 2015, the yield on interest earning assets decreased by 0.17% and the cost of interest bearing liabilities decreased by 0.01%. The net interest margin was 3.37% for the second quarter of 2016 and 3.53% for the second quarter of 2015. The net interest margin decline was mainly a result of originating loans at the current market rate in order to increase loan volume and attempt to maintain total net interest income and to avoid purchasing lower yielding investments that appear to have more interest rate risk than warranted by the yield.

Average earning assets were $1,076,000,000 during the second quarter of 2016, an increase of $45,000,000 from the average for the second quarter of 2015. Average interest bearing liabilities were $864,000,000 in the second quarter of 2016, an increase of $23,000,000 from the same quarter in 2015. Non-interest demand deposits increased $17,000,000 on average.

Provision for Loan Losses

The provision for loan losses was $0 in the second quarters of 2016 and 2015. The determination of no need for additional provision was a result of the analysis of the adequacy of the allowance for loan losses calculation, as well as continuing improvement in asset quality, including nonaccrual loans decreasing by 0.3% and all substandard loans decreasing by 19.6% since June 30, 2015. Nonaccrual loans increased by 12.4%, or $459,000, since December 31, 2015, however all substandard loans decreased by 17.8% in that period. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors. For more information, please refer to *Allowance for Loan Losses* in the following Financial Condition section of this Management s Discussion and Analysis of Financial Condition and Results of Operations. ACNB charges confirmed loan losses to the allowance and credits the allowance for recoveries of previous loan charge-offs. For the second quarter of 2016, the Corporation had net recovery of $96,000, as compared to net charge-offs of $200,000 for the second quarter of 2015.

Other Income

Total other income was $3,811,000 for the three months ended June 30, 2016, up $572,000, or 17.7%, from the second quarter of 2015. Fees from deposit accounts decreased by $9,000, or 1.5%, due to decreased volume. Fee volume varies with balance levels, account transaction activity, and customer-driven events such as overdrawing account balances. Various specific government regulations effectively limit fee assessments related to deposit accounts, making future revenue levels uncertain. Revenue from ATM and debit card transactions decreased by $2,000 or 0.5%, to $391,000 due to lower volume. The longer term trend had been increases resulting from consumer desire to use more electronic delivery channels; however, regulations or legal challenges for large financial institutions may impact industry pricing for such transactions and fees in connection therewith in future periods, the effect of which cannot be currently quantified. A more immediate challenge to this revenue source is the retail system wide security breaches in the merchant base that are negatively affecting consumer confidence in the debit card channel. Income from fiduciary activities, which include both institutional and personal trust and investment management services, totaled $434,000 for the three months ended June 30, 2016, as compared to $377,000 for the second quarter of 2015, a 15.1% increase as a result of higher fee volume from increased assets under management and higher estate fee income, which is inherently sporadic in nature. Earnings on bank-owned life insurance increased by $5,000, or 1.8%, as a result of increased accreted values. At the Corporation s wholly-owned insurance subsidiary, Russell Insurance Group, Inc. (RIG), revenue was up by $101,000, or 8.2%, to $1,328,000 partially due to higher contingent commissions. A continuing risk to RIG revenue is nonrenewal of large commercial accounts and actions by insurance carriers to reduce commissions paid to agencies such as RIG. Contingent or extra commission payments from insurance carriers are received in the second quarter of each year. Heightened pressure on commissions is expected to continue in this business line from insurance company actions; and contingent commissions are not predictable. The second quarter of 2015 recorded $101,000 gains on sales of investments (to reduce exposure to the municipal market) while the second quarter of 2016 experienced a $449,000 gain on the sale of the bank s downtown Gettysburg administrative office building (in order to gain better efficiencies). Other income in the quarter ended June 30, 2016, was up by $72,000, or 26.5%, to $344,000 due to more volume on fees related to sales of residential mortgages.

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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. Accounting rules permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The goodwill impairment analysis currently used by the Corporation is a two-step test. The first step, used to identify potential impairment, involves comparing the reporting unit s estimated fair value to its carrying value, including goodwill. If the estimated fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. The testing for potential impairment involved methods that include both current and projected income amounts, and RIG s fair value remained above the carrying value as of the most recent annual impairment test date. Thus, the results of the annual evaluations determined that there is no impairment of goodwill, including the testing at October 1, 2015. 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. 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.

Other Expenses

The largest component of other expenses is salaries and employee benefits, which increased by $241,000, or 4.5%, when comparing the second quarter of 2016 to the same quarter a year ago. Overall, the increase in salaries and employee benefits was the result of:

- increased staff in support functions and higher skilled mix of employees necessitated by regulations and growth;

- normal merit increases to employees and associated payroll taxes;

- higher performance-based commissions and incentives;

- higher employee benefit plan costs, including health insurance;

- increases related to 401(k) plan and non-qualified retirement plan benefits; and,

- increased defined benefit pension expense, which was up by $75,000, or 258.6%, when comparing the three months ended June 30, 2016, to the three months ended June 30, 2015, resulting from a continued low discount rates which increases the future pension obligations, lack of return on assets in 2015 due to market conditions and changes in actuarial assumptions reflecting increased longevity.

The Corporation s overall pension plan investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers.

The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation s risk tolerance on contribution levels, funded status, plan expense, as well as any applicable regulatory requirements. However, the determination of future benefit expense is also dependent on the fair value of assets and the discount rate on the year-end measurement date, which in recent years has experienced fair value volatility and low discount rates. The expense could also be higher in future years due to further lowered discount rate at the latest measurement date, lower plan returns, and change in mortality tables utilized. The ACNB plan has maintained a well-funded status under ERISA rules.

Net occupancy expense decreased by $19,000, or 3.6%, mostly due to lower utilities and building repairs. Equipment expense increased by $4,000, or 0.5%, as a result of additional technology costs.

Professional services expense totaled $198,000 for the second quarter of 2016, as compared to $179,000 for the same period in 2015, an increase of $19,000, or 10.6%. This category includes expenses related to legal corporate governance, risk and compliance management engagements, and legal counsel matters in connection with loans. It varies with specific engagements that are not on a regular recurring basis.

Marketing and corporate relations expenses were $151,000 for the quarter, or 18.9% higher in the second quarter of 2016, as compared to the same period of 2015. Marketing expense varies with the timing and amount of budgeted advertising production and media expenditures, typically related to the promotion of certain in-market banking and trust products. Some of the higher expense in 2016 was also related to the opening of a new retail banking office location and the relocation of another office.

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 expense was $39,000 and $81,000 for the quarters ended June 30, 2016 and 2015, respectively. The expense varies based upon the number and mix of commercial and residential real estate properties, unpaid property taxes, and deferred maintenance required upon acquisition. In addition, some properties suffer decreases in value after acquisition, requiring write-downs to fair value during the prolonged marketing cycles for these distressed properties. Foreclosed assets held for resale expenses or recoveries will vary in the remainder of 2016 depending on the successful closing of sales agreements on some existing properties and the unknown expenses related to new properties acquired.

Other tax expense decreased by $43,000, or 18.2%, comparing the quarters ended June 30, 2016 and 2015, due to adjusting the accruals for the Bank Shares Tax in each period. The Pennsylvania Bank Shares Tax is a shareholders equity-based tax and is subject to increases based on state government budget proposals. The most recent Pennsylvania budget raises the Bank Shares Tax from 0.89% to 0.95% effective January 1, 2017. Supplies and postage expense decreased by 27.8% in part due to variation in timing of postage refills and sporadic supply reorders. FDIC and regulatory expense increased 7.4% based on balance sheet base increases and scheduled state regulatory rate increases. Intangible amortization increased 1.2% due to amortization of the RIG purchased small books of business in 2015. Other operating expenses increased by $121,000, or 14.1%, in the second quarter of 2016, as compared to the second quarter of 2015. Increases and decreases included normal variations for electronic delivery channels, telecommunications, and director fees, as well as various other categories. Losses, which include the expense of reimbursing debit card customers for unauthorized transactions to their accounts resulting from various merchant database breaches and other third-party fraudulent use, added approximately $11,000 to other expenses in the second quarter of 2016 compared to $15,000 in 2015. These third-party breaches also cause additional card inventory and processing costs to the Corporation, none of which is expected to be recovered from the third-party merchants or other parties where the breaches occur. The debit card electronic delivery channel is valued by customers and provides significant revenue to the Corporation. The expense related to reimbursements is unpredictable and varying, but ACNB has policies and procedures to limit exposure.

Provision for Income Taxes

The Corporation recognized income taxes of $1,047,000, or 26.0% of pretax income, during the second quarter of 2016, as compared to $944,000, or 25.1% of pretax income, during the same period in 2015. The variances from the federal statutory rate of 34% in both periods are generally due to tax-exempt income from investments in and loans to state and local units of government at below-market rates (an indirect form of taxation), investment in bank-owned life insurance, and investments in low-income housing partnerships (which qualify for federal tax credits). Low-income housing tax credits were $72,000 for the second quarter of 2016, compared to $75,000 for the second quarter of 2015.

Six Months ended June 30, 2016, compared to Six Months ended June 30, 2015

Executive Summary

Net income for the six months ended June 30, 2016, was $5,529,000, compared to $5,353,000 for the same six months in 2015, an increase of $176,000 or 3.3%. Earnings per share was $0.91 in 2016 and $0.89 in 2015. Net interest income increased $140,000, or 0.8%, due to increases in total interest income and decreases in total interest expense. Provision for loan losses was $0, no change from the same period in 2015, based on the adequacy analysis of the allowance for loan losses calculation at the end of each period, resulting in an allowance to total loans of 1.69% at June 30, 2016. Other income increased $651,000, or 10.8%, due in part to a gain on sale of premises and equipment. Other expenses increased $556,000, or 3.3%, due in part to higher salary/benefits from a change to higher skilled and compensated staff and higher per employee benefit cost.

Net Interest Income

Net interest income totaled $18,037,000 for the six months ended June 30, 2016, compared to $17,897,000 for the same period in 2015, an increase of $140,000, or 0.8%. Net interest income increased due to an increase in interest income and a decrease in interest expense. Interest income increased $118,000, or 0.6%, due to changing the mix of earning assets to more lending in the Corporation s marketplace funded partially from paydowns in the lower yielding investment portfolio. In addition, all periods have varying amounts of non recurring collection of interest and prepayment penalties. The decrease in interest expense resulted from a change in funding mix to more lower cost market-based deposits. Increased lending was a result of a concerted effort to offset the recent year trend of interest income decreases due to slow economic activity and declines in the U.S. Treasury yields and other market driver interest rates. These driver rates affect new loan originations and are indexed to a portion of the loan portfolio in that a decrease in the driver rates decreases the yield on new loans and on existing loans at subsequent interest rate reset dates. In this manner, interest income yield is negatively affected as new loans replace paydowns on existing loans and variable rate loans reset to new lower rates. Interest income was lower on investment securities as paydowns were reinvested to provide pledging for certain deposit accounts despite the continued low market rates, which were a result of uneven domestic and international economic conditions. An appropriate amount of earning assets remained in short-term, low-rate money market type accounts during the first six months of 2016; even with increased loan demand, there exists ample ability to borrow at low rates for liquidity needs. The ability to increase lending is contingent on the effects of intense competition that can reduce new loans and may result in the payoff of existing loans, as well as economic conditions in the Corporation s marketplace. As to funding costs, interest rates on alternative funding sources, such as the FHLB, and other market driver rates are factors in rates the Corporation and the local market pay for deposits. However, during the first half of 2016, several of the core deposit rates continued at practical floors after the Federal Open Market Committee (FOMC) decreased the Federal Funds Target Rate by 400 basis points during 2008 and has maintained it at 0% since that time. In mid-December 2015 the rate was increased to 0.25% - 0.50%. Interest expense decreased $22,000, or 1.1%, due to a change in the mix of funding to more lower cost market-based deposits versus wholesale borrowings. This trend is not expected to continue due to competing non-bank money market funding products that gained an advantage when the Federal Reserve FOMC raised short-term rates in mid December 2015. For more information about interest rate risk, please refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk in the Annual Report on Form 10-K for the fiscal year ended December 31, 2015, and filed with the SEC on March 4, 2016. Over the longer term, the Corporation continues its strategic direction to increase asset yield and interest income by means of loan growth and rebalancing the composition of earning assets.

The net interest spread for the first six months of 2016 was 3.31% compared to 3.46% during the same period in 2015. Also comparing the first six months of 2016 to 2015, the yield on interest earning assets decreased by 0.17% and the cost of interest bearing liabilities decreased by 0.01%. The net interest margin was 3.40% for the first six months of 2016 and 3.55% for the same period in 2015. The net interest margin decline was mainly a result of originating loans at the going market rate in order to increase loan volume and total net interest income and purchasing lower yielding investments to provide proper pledging while no change in funding rates.

Average earning assets were $1,064,000,000 during the first six months of 2016, an increase of $46,000,000 from the average for the first six months of 2015. Average interest bearing liabilities were $860,000,000 in the first six months of 2016, an increase of $25,000,000 from the same period in 2015. Non-interest demand deposits increased $17,000,000 on average.

Provision for Loan Losses

The provision for loan losses was $0 in the first six months of 2016 and 2015. The determination of no need for additional provision was a result of the analysis of the adequacy of the allowance for loan losses calculation, as well as continuing improvement in asset quality, including nonaccrual loans decreasing by 0.3% and all substandard loans decreasing by 19.6% since June 30, 2015. Nonaccrual loans increased by 12.4%, or $459,000, since December 31, 2015, however all substandard loans decreased by 17.8% in that period. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors. For more information, please refer to *Allowance for Loan Losses* in the following Financial Condition section of this Management s Discussion and Analysis of Financial Condition and Results of Operations. ACNB charges confirmed loan losses to the allowance and credits the allowance for recoveries of previous loan charge-offs. For the first six months of 2016, the Corporation had net charge-offs of $111,000, as compared to net charge-offs of $307,000 for the first six months of 2015.

Other Income

Total other income was $6,683,000 for the six months ended June 30, 2016, up $651,000, or 10.8%, from the first six months of 2015. Fees from deposit accounts decreased by $7,000, or 0.6%, due to decreased volume. Fee volume varies with balance levels, account transaction activity, and customer-driven events such as overdrawing account balances. Various specific government regulations effectively limit fee assessments related to deposit accounts, making future revenue levels uncertain. Revenue from ATM and debit card transactions decreased by $8,000, or 1.1%, to $746,000 due to lower volume. The longer term trend had been increases resulting from consumer desire to use more electronic delivery channels; however, regulations or legal challenges for large financial institutions may impact industry pricing for such transactions and fees in connection therewith in future periods, the effect of which cannot be currently quantified. A more immediate challenge to this revenue source is the retail system wide security breaches in the merchant base that are negatively affecting consumer confidence in the debit card channel. Income from fiduciary activities, which include both institutional and personal trust and investment management services, totaled $828,000 for the six months ended June 30, 2016, as compared to $740,000 for the six months ended June 30, 2015, an 11.9% increase as a result of higher fee volume from increased assets under management and higher estate fee income, which is inherently sporadic in nature. Earnings on bank-owned life insurance increased by $11,000, or 2.0%, as a result of increased accreted values. At the Corporation s wholly-owned insurance subsidiary, Russell Insurance Group, Inc. (RIG), revenue was up by $151,000, or 6.6%, to $2,431,000 partially due to higher contingent commissions. A continuing risk to RIG revenue is nonrenewal of large commercial accounts and actions by insurance carriers to reduce commissions paid to agencies such as RIG. Contingent or extra commission payments from insurance carriers are received in the second quarter of each year. Heightened pressure on commissions is expected to continue in this business line from insurance company actions; and contingent commissions are not predictable. The second quarter of 2015 recorded $101,000 gains on sales of investments (to reduce exposure to the municipal market) while the second quarter of 2016 experienced a $449,000 gain on the sale of a bank administrative office building (in order to gain better efficiencies). Other income in the six months ended June 30, 2016, was up by $68,000, or 13.6%, to $568,000 due to fees related to sales of residential mortgages.

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. Accounting rules permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The goodwill impairment analysis currently used by the Corporation is a two-step test. The first step, used to identify potential impairment, involves comparing the reporting unit s estimated fair value to its carrying value, including goodwill. If the estimated fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds the estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. The testing for potential impairment involved methods that include both current and projected income amounts, and RIG s fair value remained above the carrying value as of the most recent annual impairment test date. Thus, the results of the annual evaluations determined that there is no impairment of goodwill, including the testing at October 1, 2015. 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. 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.

Other Expenses

The largest component of other expenses is salaries and employee benefits, which increased by $441,000, or 4.2%, when comparing the first six months of 2016 to the same period a year ago. Overall, the increase in salaries and employee benefits was the result of:

- increased staff in support functions and higher skilled mix of employees necessitated by regulations and growth;
- normal merit increases to employees and associated payroll taxes;
- higher performance-based commissions and incentives;
- higher employee benefit plan costs, including health insurance;
- increases related to 401(k) plan and non-qualified retirement plan benefits; and,
- increased defined benefit pension expense, which was up by $150,000, or 258.6%, when comparing the six months ended June 30, 2016, to June 30, 2015, resulting from continued low discount rates which increases the future pension obligations, lack of return on assets in 2015 due to market conditions and changes in actuarial assumptions reflecting increased longevity.

The Corporation s overall pension plan investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation s risk tolerance on contribution levels, funded status, plan expense, as well as any applicable regulatory requirements. However, the determination of future benefit expense is also dependent on the fair value of assets and the discount rate on the year-end measurement date, which in recent years has experienced fair value volatility and low discount rates. The expense could also be higher in future years due to further lowered discount rate at the latest measurement date, lower plan returns, and change in mortality tables utilized. The ACNB plan has maintained a well-funded status under ERISA rules.

Net occupancy expense decreased by $52,000, or 4.6%, mostly due to less winter weather related expense. Equipment expense increased by $7,000, or 0.5%, as a result of additional technology costs.

Professional services expense totaled $453,000 during the first six months of 2016, as compared to $424,000 for the same period in 2015, an increase of $29,000, or 6.8%. This category includes expenses related to legal corporate governance, risk and compliance management engagements, and legal counsel matters in connection with loans. It varies with specific engagements that are not on a regular recurring basis.

Marketing and corporate relations expenses were $268,000 for the first six months of 2016, or 30.7% higher, as compared to the same period of 2015. Marketing expense varies with the timing and amount of budgeted advertising production and media expenditures, typically related to the promotion of certain in-market banking and trust products. Some of the higher expense in 2016 was also related to the opening of the new retail banking office location and the relocation of another office.

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 expense was $40,000 and $108,000 for the six months ended June 30, 2016 and 2015, respectively. The expense varies based upon the number and mix of commercial and residential real estate properties, unpaid property taxes, and deferred maintenance required upon acquisition. In addition, some properties suffer decreases in value after acquisition, requiring write-downs to fair value during the prolonged marketing cycles for these distressed properties. Foreclosed assets held for resale expenses or recoveries will vary in the remainder of 2016 depending on the successful closing of sales agreements on some existing properties and the unknown expenses related to new properties acquired.

Other tax expense decreased by $7,000, or 1.8% comparing the six months ended June 30, 2016 and 2015, due to adjusting the accruals for Shares Tax in each period. The Pennsylvania shareholders equity-based tax is subject to increases based on state government budget proposals. Supplies and postage expense decreased by 1.6% in part due to variation in timing of postage refills and sporadic supply reorders. FDIC and regulatory expense increased 6.7% based on balance sheet base increases and scheduled state regulatory rate increases. Intangible amortization increased 4.2% due to amortization of the RIG purchased small books of business in 2015. Other operating expenses increased by $119,000, or 7.3%, in the first six months of 2016, as compared to the first six months of 2015. Increases and decreases included normal variations for electronic delivery channels, telecommunications, and director fees, as well as various other categories. Losses, which include the expense of reimbursing debit card customers for unauthorized transactions to their accounts resulting from various merchant database breaches and other third-party fraudulent use, added approximately $22,000 to other expenses in the first half of 2016 compared to $27,000 in the first half 2015. These third-party breaches also cause additional card inventory and processing costs to the Corporation, none of which is expected to be recovered from the third-party merchants or other parties where the breaches occur. The debit card electronic delivery channel is valued by customers and provides significant revenue to the Corporation. The expense related to reimbursements is unpredictable and varying, but ACNB has policies and procedures to limit exposure.

Provision for Income Taxes

The Corporation recognized income taxes of $1,870,000, or 25.3% of pretax income, during the first six months of 2016, as compared to $1,811,000, or 25.3% of pretax income, during the same period in 2015. The variances from the federal statutory rate of 34% in both periods are generally due to tax-exempt income from investments in and loans to state and local units of government at below-market rates (an indirect form of taxation), investment in bank-owned life insurance, and investments in low-income housing partnerships (which qualify for federal tax credits). Low-income housing tax credits were $144,000 for the six months ended June 30, 2016 compared to $150,000 for the six months ended June 30, 2015.

FINANCIAL CONDITION

Assets totaled $1,169,110,000 at June 30, 2016, compared to $1,147,925,000 at December 31, 2015, and $1,106,251,000 at June 30, 2015. Average earning assets during the six months ended June 30, 2016, increased to $1,064,226,000 from $1,018,424,000 during the same period in 2015. Average interest bearing liabilities increased in 2016 to $860,164,000 from $835,498,000 in 2015, while average non-interest bearing deposits increased by $17,045,000.

Investment Securities

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

At June 30, 2016, the securities balance included a net unrealized gain on available for sale securities of $1,987,000, net of taxes, on amortized cost of $113,991,000 versus a net unrealized gain of $1,164,000, net of taxes, on amortized cost of $123,929,000 at December 31, 2015, and a net unrealized gain of $2,040,000, net of taxes, on amortized cost of $104,151,000 at June 30, 2015. The change in fair value of available for sale securities during 2016 was the result of changes in the U.S. Treasury yield curve rates, and the spread from this yield curve required by investors on the types of investment securities that ACNB owns. Even though the Federal Reserve ceased their rate-decreasing Quantitative Easing program in 2014 and increased the fed funds rate in mid-December 2015, events in the domestic and international economies caused interest rates to continue to remain low and volatile. Actions or lack of actions by the Federal Reserve to move off of low short-term interest rate policy and markets concern about global economic conditions lead to fair values being volatile on any given day in all periods presented.

At June 30, 2016, the securities balance included held to maturity securities with an amortized cost of $59,681,000 and a fair value of $60,897,000, as compared to an amortized cost of $71,542,000 and a fair value of $71,363,000 at December 31, 2015, and an amortized cost of $75,719,000 and a fair value of $75,665,000 at June 30, 2015. The held to maturity securities are U.S. government agency debentures and pass-through mortgage-backed securities in which the full payment of principal and interest is guaranteed; however, they were not classified as available for sale because these securities are generally used as required collateral for certain eligible government accounts or repurchase agreements. They are also held for possible pledging to access additional liquidity for banking subsidiary needs in the form of FHLB borrowings.

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

The fair values of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1) or by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific security but rather by relying on the security s relationship to other benchmark quoted prices. The Corporation uses independent service providers to provide matrix pricing. Please refer to Note 7 Securities in the Notes to Consolidated Financial Statements for more information on the security portfolio and Note 9 Fair Value Measurements in the Notes to Consolidated Financial Statements for more information about fair value.

Loans

Loans outstanding increased by $49,833,000, or 6.1%, from June 30, 2015, to June 30, 2016, and increased by $13,872,000, or 1.6%, from December 31, 2015, to June 30, 2016. The year-over-year increase in loan volume, as discussed below, was the result of determined efforts to lend to creditworthy borrowers subject to the Corporation s disciplined underwriting standards, despite the continued slow economic conditions and intense competition. In all periods, residential real estate lending and refinance activity was slow and commercial loans were subject to refinancing to competition for different rates or terms. More payoffs are anticipated in the remainder of 2016 from either customers cash reserves or refinancing at competing banks. Nonetheless, during the first six months of 2016, total commercial purpose loans increased, while local market portfolio residential mortgages decreased. Total commercial purpose segments increased $17,187,000, or 4.1%, as compared to December 31, 2015. These loans are spread among diverse categories that include municipal governments/school districts, commercial real estate, commercial real estate construction, and commercial and industrial. Residential real estate mortgage lending, which includes smaller commercial purpose loans secured by the owner s home, decreased by $3,228,000, or 0.8%, as compared to December 31, 2015. These loans are to local borrowers who preferred loan types that would not be sold into the secondary mortgage market. Of the $414,124,000 total in residential mortgage loans at June 30, 2016, $95,797,000 were secured by junior liens or home equity loans, which are also in many cases junior liens. Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a senior security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market weakens, property values deteriorate, or rates increase sharply. Non-real estate secured consumer loans comprise less than 2.0% of the portfolio, with automobile-secured loans representing 0.07% of the portfolio.

Most of the Corporation s lending activities are with customers located within southcentral Pennsylvania and in the northern Maryland area that is proximal to its Pennsylvania retail banking offices. This region currently and historically has lower unemployment than the U.S. as a whole. Included in commercial real estate loans are loans made to lessors of non-residential properties that total $151,689,000, or 17.5% of total loans, at June 30, 2016. These borrowers are geographically dispersed throughout ACNB s marketplace and are leasing commercial properties to a varied group of tenants including medical offices, retail space, and other commercial purpose facilities. Because of the varied nature of the tenants, in aggregate, management believes that these loans present an acceptable risk when compared to commercial loans in general. ACNB does not originate or hold Alt-A or subprime mortgages in its loan portfolio.

Allowance for Loan Losses

ACNB maintains the allowance for loan losses at a level believed to be adequate by management to absorb probable 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 twelve quarters for each specific loan pool. Additionally, management adjusts projected loss ratios for other factors, including the following:

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

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

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

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

- other potential exposure in the loan portfolio;

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

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

The unallocated portion of the allowance is deemed to be appropriate as it reflects an uncertainty that remains in the loan portfolio; specifically reserves where the Corporation believes that tertiary losses are probable above the loss amount derived using appraisal-based loss estimation, where such additional loss estimates are in accordance with regulatory and GAAP guidance. Appraisal-based loss derivation does not fully develop the loss present in certain unique, ultimately bank-owned collateral. The Corporation has determined that the amount of provision in 2016 and the resulting allowance at June 30, 2016, are appropriate given the continuing level of risk in the loan portfolio. Further, management believes the unallocated allowance is appropriate, because even though the impaired loans added since 2015 demonstrate generally low risk due to adequate real estate collateral, the value of such collateral can decrease; plus, the growth in the loan portfolio is centered around commercial real estate which continues to have little increase in value and low liquidity. In addition, there are certain loans that, although they did not meet the criteria for impairment, management believes there was a strong possibility that these loans represented potential losses at June 30, 2016.

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

Management bases the provision for loan losses, or lack of provision, on the overall analysis taking into account the methodology discussed above. The provision for year-to-date June 30, 2016 and 2015, was $0. More specifically, even though total loans increased, there was no provision expense because of the fact that most impaired credits were, in the opinion of management, adequately collateralized. Management believes that the lack of provision reflects that potential losses inherent in the portfolio were reflected in previous period provision expense consistent with recent improving credit quality in the loan portfolio.

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

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss (CECL) model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. Upon adoption, the change in this accounting guidance could result in an increase in the Corporation s allowance for loan losses and require the Corporation to record loan losses more rapidly.

The allowance for loan losses at June 30, 2016, was $14,636,000, or 1.69% of loans, as compared to $14,865,000, or 1.82% of loans, at June 30, 2015, and $14,747,000, or 1.73% of loans, at December 31, 2015.

Changes in the allowance for loan losses were as follows:

In thousands	**Six Months Ended June 30, 2016**	**Year Ended December 31, 2015**	**Six Months Ended June 30, 2015**
Beginning balance - January 1	**$ 14,747**	$ 15,172	$ 15,172
Provisions charged to operations			
Recoveries on charged-off loans	**184**	512	371
Loans charged-off	**(295)**	(937)	(678)
Ending balance	**$ 14,636**	$ 14,747	$ 14,865

Loans past due 90 days and still accruing were $1,634,000 and nonaccrual loans were $4,158,000 as of June 30, 2016. $417,000 of the nonaccrual balance at June 30, 2016, were in troubled debt restructured loans. $6,703,000 of the impaired loans were accruing troubled debt restructured loans. Loans past due 90 days and still accruing were $1,646,000 at June 30, 2015, while nonaccruals were $4,169,000. $697,000 of the nonaccrual balance at June 30, 2015, was in troubled debt restructured loans. $6,881,000 of the impaired loans were accruing troubled debt restructured loans. Loans past due 90 days and still accruing were $2,132,000 at December 31, 2015, while nonaccruals were $3,699,000. $534,000 of the nonaccrual balance at December 31, 2015, were in troubled debt restructured loans. $6,792,000 of the impaired loans were accruing troubled debt restructured loans. Total additional loans classified as substandard (potential problem loans) at June 30, 2016, June 30, 2015, and December 31, 2015, were approximately $4,275,000, $7,311,000 and $7,474,000, respectively.

Information on nonaccrual loans, by collateral type rather than loan class, at June 30, 2016, as compared to December 31, 2015, is as follows:

Dollars in thousands	Number of Credit Relationships		Balance		Specific Loss Allocations		Current Year Charge-Offs	Location	Originated
June 30, 2016									
Commercial real estate construction	**1**	**$**	**300**	**$**		**$**		**In market**	**2014**
Owner occupied commercial real estate	**9**		**1,844**					**In market**	**1995 - 2012**
Investment/rental residential real estate	**4**		**541**		**164**			**In market**	**2003 - 2011**
Commercial and industrial	**2**		**1,473**					**In market**	**2006 - 2007**
Total	**16**	**$**	**4,158**	**$**	**164**	**$**			
December 31, 2015									
Commercial real estate construction	2	$	374	$		$		In market	2006 - 2014
Owner occupied commercial real estate	10		1,676					In market	1995 - 2012
Investment/rental residential real estate	3		178					In market	2003 - 2011
Commercial and industrial	2		1,471					In market	2006 - 2007
Total	17	$	3,699	$		$			

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

All nonaccrual impaired loans are to borrowers located within the market area served by the Corporation in southcentral Pennsylvania and nearby areas of northern Maryland. All nonaccrual impaired loans were originated by ACNB s banking subsidiary, except for one participation loan discussed below, between 1995 and 2014 for purposes listed in the classifications in the table above.

Included in commercial real estate construction at June 30, 2016, the Corporation had one impaired and nonaccrual loan of $300,000 to finance an investment real estate project in the Corporation s primary trading area of southcentral Pennsylvania. The loan had standard terms and conditions, including repayment from the permanent financing of property and no interest reserves, and was originated during 2014. The loan is in standard collection and legal processes. On another loan previously in this category, foreclosure was held in abeyance while allowing the pursuit of a workout plan. The workout plan resulted in payment of the impaired nonaccrual balance concluding in the second quarter 2016.

Owner occupied commercial real estate at June 30, 2016, includes nine unrelated loan relationships, all of which but a $590,000 loan relationship for a historic dwelling farm, have balances of less than $435,000 each, for which the real estate is collateral and is used in connection with a business enterprise that is suffering economic stress or is out of business. The historic dwelling loan, with normal terms and conditions, was added to nonaccrual in the first quarter of 2016 and is supported by a recent appraisal. A restaurant-related loan with normal terms and conditions, was added to nonaccrual in the first quarter of 2012 is supported by a recent appraisal and the loan is current with restructured payments. The other loans in this category were originated between 1995 and 2012 and are business loans impacted by the general economic downturn that has not recovered. Collection efforts will continue until it is deemed in the best interest of the Corporation to initiate foreclosure procedures.

Investment/rental residential real estate at June 30, 2016, includes four loan relationships totaling $541,000 for which the real estate is collateral and the purpose of which is for speculation, rental, or other non-owner occupied uses. One $372,000 loan added in the second quarter of 2016 has a $164,000 specific loss allocation based on a current appraisal.

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Included in impaired commercial and industrial loans at June 30, 2016, is a participation loan with standard terms and conditions including repayment from conversion of trade assets for a business in southcentral Pennsylvania in Chapter 11 bankruptcy that has a balance of $1,258,000. This loan was moved to nonaccrual in the third quarter of 2014 after becoming delinquent with no indication of when regular payments would resume. Besides trade assets, the loan is fully guaranteed by a government sponsored entity so no specific allocation was deemed to be necessary. A $215,000 loan was added in the second quarter of 2016 with standard terms and conditions including repayment from conversion of trade assets for a business in southcentral Pennsylvania in process of liquidation. The plan is to reduce or pay the balance with accounts receivable as collected.

The Corporation utilizes a systematic review of its loan portfolio on a quarterly basis in order to determine the adequacy of the allowance for loan losses. In addition, ACNB engages the services of an outside independent loan review function and sets the timing and coverage of loan reviews during the year. The results of this independent loan review are included in the systematic review of the loan portfolio. The allowance for loan losses consists of a component for individual loan impairment, primarily based on the loan s collateral fair value and expected cash flow. A watch list of loans is identified for evaluation based on internal and external loan grading and reviews. Loans other than those determined to be impaired are grouped into pools of loans with similar credit risk characteristics. These loans are evaluated as groups with allocations made to the allowance based on historical loss experience adjusted for current trends in delinquencies, trends in underwriting and oversight, concentrations of credit, and general economic conditions within the Corporation s trading area. The provision expense was based on the loans discussed above, as well as current trends in the watch list and the local economy as a whole. The charge-offs discussed elsewhere in this Management s Discussion and Analysis create the recent loss history experience and result in the qualitative adjustment which, in turn, affects the calculation of losses inherent in the portfolio. The lack of provision for loan losses for 2016 and 2015 was a result of the measurement of the adequacy of the allowance for loan losses at each period. More specifically, even though nonaccrual and substandard loans increased in the first quarter 2016, no provision addition to the allowance was necessary in proportion to nonaccrual and substandard loans increase in accordance with management s belief that adequate collateralization generally exists for these loans in accordance with GAAP. Each quarter, the Corporation assesses risk in the loan portfolio compared with the balance in the allowance for loan losses and the current evaluation factors.

Premises and Equipment

During the quarter ended June 30, 2016 a building was sold and the Corporation is leasing back a portion of that building. In connection with these transactions, a gain of $1,147,000 was realized, of which $447,000 was recognized in the quarter ended June 30, 2016 and $700,000 will be recognized over the lease term.

Foreclosed Assets Held for Resale

Foreclosed assets held for resale consists of the fair value of real estate acquired through foreclosure on real estate loan collateral or the acceptance of ownership of real estate in lieu of the foreclosure process. These fair values, less estimated costs to sell, become the Corporation s new cost basis. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. The carrying value of real estate acquired through foreclosure totaled $730,000 for five properties to five unrelated borrowers at June 30, 2016, compared to $580,000 for seven unrelated properties at December 31, 2015. The increase in the carrying value was due to asset values of an additional property added, less three properties that were sold. All properties are actively being marketed. The Corporation expects to obtain and market additional foreclosed assets through the remainder of 2016; however, the total amount and timing is currently not certain.

Deposits

ACNB relies on deposits as a primary source of funds for lending activities with total deposits of $922,227,000 as of June 30, 2016. Deposits increased by $50,058,000, or 5.7%, from June 30, 2015, to June 30, 2016, and increased by $9,247,000, or 1.0%, from December 31, 2015, to June 30, 2016. Deposits vary between quarters mostly reflecting different levels held by local government and school districts during different times of the year. ACNB s deposit pricing function employs a disciplined pricing approach based upon alternative funding rates, but also strives to price deposits to be competitive with relevant local competition, including credit unions and larger regional banks. During the recession and subsequent slow recovery, deposit growth mix experienced a shift to transaction accounts as customers put more value in liquidity and FDIC insurance. Products, such as money market accounts and interest-bearing transaction accounts that had suffered declines in past years, continued with recovered balances; however, more recent trends suggest a return to more normal, lower balances. With persistent low market interest rates in a slow economy, ACNB s ability to maintain and add to its deposit base may be impacted by the reluctance of consumers to accept low rates and by competition willing to pay above market rates to attract market share. Alternatively, if rates rise rapidly and the equity markets improve, funds could leave the Corporation or be priced higher to maintain similar levels.

Borrowings

Short-term borrowings are comprised primarily of securities sold under agreements to repurchase and short-term borrowings from the FHLB. As of June 30, 2016, short-term borrowings were $36,190,000, as compared to $35,202,000 at December 31, 2015, and $34,402,000 at June 30, 2015. Agreements to repurchase accounts are within the commercial customer base and have attributes similar to core deposits. Investment securities are pledged in sufficient amounts to collateralize these agreements. In comparison to year-end 2015, repurchase agreement balances were up $988,000, or 2.8%, due to changes in the cash flow position of ACNB s commercial and local government customer base despite competition from non bank sources. There were no short-term FHLB borrowings at June 30, 2016, December 31, 2015, and June 30, 2015. Short-term FHLB borrowings are used to even out funding from seasonality and daily fluctuations in the deposit base. Long-term borrowings consist primarily of longer-term advances from the FHLB that provide term funding of loan assets and contribute to a more balanced net repricing position. In addition, this category in prior periods included a loan from a commercial bank to fund the purchase of RIG which was paid from corporate funds in the third quarter 2015. Long-term borrowings totaled $80,500,000 at June 30, 2016, versus $76,500,000 at December 31, 2015, and $78,799,000 at June 30, 2015. The Corporation increased long-term borrowings from June 30, 2015, even though deposits were available to fund loan demand and amounts were available from investment cash flow, because the FHLB has longer duration. To replace normal FHLB maturities, laddered FHLB fixed-rate term advances were taken in 2016 and 2015 to reduce net liability sensitivity and to take advantage of lower rates. Further borrowings will be used when necessary for a variety of risk management and funding purposes. Please refer to the *Liquidity* discussion below for more information on the Corporation s ability to borrow.

Capital

ACNB s capital management strategies have been developed to enhance long-term shareholder value, while maintaining its well-capitalized regulatory position in relationship to its risk exposure. Total stockholders equity was $119,277,000 at June 30, 2016, compared to $114,715,000 at December 31, 2015, and $112,901,000 at June 30, 2015. Stockholders equity increased in the first six months of 2016 by $4,562,000 due in part to $3,112,000 in earnings retained in capital. A $1,048,000 decrease in accumulated other comprehensive loss was a result of a net increase in the fair value of the investment portfolio and changes in the net funded position of the defined benefit pension plan. Other comprehensive income or loss is mainly caused by fixed-rate investment securities gaining or losing value in different interest rate environments and changes in the net funded position of the defined benefit pension plan.

The primary source of additional capital to ACNB is earnings retention, which represents net income less dividends declared. During the first six months of 2016, ACNB earned $5,529,000 and paid dividends of $2,417,000 for a dividend payout ratio of 43.7%. During the first six months of 2015, ACNB earned $5,353,000 and paid dividends of $2,407,000 for a dividend payout ratio of 45.0%.

ACNB Corporation has a Dividend Reinvestment and Stock Purchase Plan that provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. Year-to-date June 30, 2016, 9,647 shares were issued under this plan with proceeds in the amount of $224,000. Year-to-date June 30, 2015, 14,458 shares were issued under this plan with proceeds in the amount of $297,000. Proceeds are used for general corporate purposes.

ACNB Corporation has a Restricted Stock plan available to selected officers and employees of the Bank, to advance the best interest of ACNB Corporation and its shareholders. The plan provides those persons who have responsibility for its growth with additional incentive by allowing them to acquire an ownership in ACNB Corporation and thereby encouraging them to contribute to the success of the Corporation. Year-to-date June 30, 2016, 7,435 shares were issued under this plan. No shares were issued under this plan through June 30, 2015.

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

Quantitative measures established by regulation to ensure capital adequacy require ACNB to maintain minimum amounts and ratios of total and Tier 1 capital to average assets. Management believes, as of June 30, 2016, and December 31, 2015, that ACNB s banking subsidiary met all minimum capital adequacy requirements to which it is subject and is categorized as well capitalized for regulatory purposes. There are no subsequent conditions or events that management believes have changed the banking subsidiary s category.

Regulatory Capital Changes

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

- a minimum ratio of common Tier 1 capital to risk-weighted assets of 4.5%;
- a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%;
- a minimum ratio of total capital to risk-weighted assets of 8.0%; and,
- a minimum leverage ratio of 4.0%.

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

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

The rules permanently grandfather non-qualifying capital instruments (such as trust preferred securities and cumulative perpetual preferred stock) issued before May 19, 2010, for inclusion in the Tier 1 capital of banking organizations with total consolidated assets of less than $15 billion as of December 31, 2009, and banking organizations that were mutual holding companies as of May 19, 2010. ACNB Corporation does not have trust preferred securities or cumulative perpetual preferred stock with no plans to add these to the capital structure.

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

Consistent with the Dodd-Frank Act, the new rules replace the ratings-based approach to securitization exposures, which is based on external credit ratings, with the simplified supervisory formula approach in order to determine the appropriate risk weights for these exposures. Alternatively, banking organizations may use the existing gross-up approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250 percent risk weight.

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

The Corporation calculated regulatory ratios as of June 30, 2016, and confirmed no material impact on the capital, operations, liquidity, and earnings of the Corporation and the banking subsidiary from the changes in the regulations.

Risk-Based Capital

The banking subsidiary s capital ratios are as follows:

	June 30, 2016	December 31, 2015	To Be Well Capitalized Under Prompt Corrective Action Regulations
Tier 1 leverage ratio (to average assets)	**8.98%**	8.84%	5.00%
Common Tier 1 capital ratio (to risk-weighted assets)	**13.24%**	13.22%	6.50%
Tier 1 risk-based capital ratio (to risk-weighted assets)	**13.24%**	13.22%	8.00%
Total risk-based capital ratio	**14.50%**	14.48%	10.00%

Liquidity

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

ACNB s funds are available from a variety of sources, including assets that are readily convertible such as interest bearing deposits with banks, maturities and repayments from the securities portfolio, scheduled repayments of loans receivable, the core deposit base, and the ability to borrow from the FHLB. At June 30, 2016, ACNB s banking subsidiary had a borrowing capacity of approximately $488,000,000 from the FHLB, of which $397,500,000 was available. Because of various restrictions and requirements on utilizing the available balance, ACNB considers $276,000,000 to be the practicable additional borrowing capacity, which is considered to be sufficient for operational needs. The FHLB system is self-capitalizing, member-owned, and its member banks stock is not publicly traded. ACNB creates its borrowing capacity with the FHLB by granting a security interest in certain loan assets with requisite credit quality. ACNB has reviewed information on the FHLB system and the FHLB of Pittsburgh, and has concluded that they have the capacity and intent to continue to provide both operational and contingency liquidity. The FHLB of Pittsburgh instituted a requirement that a member s investment securities must be moved into a safekeeping account under FHLB control to be considered in the calculation of maximum borrowing capacity. The Corporation currently has securities in safekeeping at the FHLB of Pittsburgh; however, the safekeeping account is under the Corporation s control. As better contingent liquidity is maintained by keeping the securities under the Corporation s control, the Corporation has not moved the securities which, in effect, lowered the Corporation s maximum borrowing capacity. However, there is no practical reduction in borrowing capacity as the securities can be moved into the FHLB-controlled account promptly if they are needed for borrowing purposes.

Another source of liquidity is securities sold under repurchase agreements to customers of ACNB s banking subsidiary totaling approximately $36,190,000 and $35,202,000 at June 30, 2016, and December 31, 2015, respectively. These agreements vary in balance according to the cash flow needs of customers and competing accounts at other financial organizations.

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

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

Off-Balance Sheet Arrangements

The Corporation is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and, to a lesser extent, standby letters of credit. At June 30, 2016, the Corporation had unfunded outstanding commitments to extend credit of approximately $221,690,000 and outstanding standby letters of credit of approximately $5,691,000. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements.

Market Risks

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

RECENT DEVELOPMENTS

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

Holding Company Capital Requirements

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

Deposit Insurance

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

Corporate Governance

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

Prohibition Against Charter Conversions of Troubled Institutions

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

Interstate Branching

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

Limits on Interstate Acquisitions and Mergers

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

Limits on Interchange Fees

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

Consumer Financial Protection Bureau

Dodd-Frank created the independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, Consumer Financial Privacy provisions of the Gramm-Leach-Bliley Act, and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB, but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower s ability to repay. In addition, Dodd-Frank allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a qualified mortgage as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE - Pursuant to Dodd-Frank as highlighted above, the CFPB issued a final rule on January 10, 2013 (effective on January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine the consumer s ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and, (8) credit history. Alternatively, the mortgage lender can originate qualified mortgages , which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a qualified mortgage is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage, the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Loans which meet these criteria will be considered qualified mortgages and, as a result, generally protect lenders from fines or litigation in the event of foreclosure. Qualified mortgages that are higher-priced (e.g., subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not higher-priced (e.g., prime loans) are given a safe harbor of compliance. The impact of the final rule, and the subsequent amendments thereto, on the Corporation s lending activities and the Corporation s statements of income or condition has had little or no impact; however, management will continue to monitor the implementation of the rule for any potential effects on the Corporation s business.

SUPERVISION AND REGULATION

Dividends

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

Regulation of Bank

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

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

Monetary and Fiscal Policy

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

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Management monitors and evaluates changes in market conditions on a regular basis. Based upon the most recent review, management has determined that there have been no material changes in market risks since year-end 2015. For further discussion of year-end information, please refer to the Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

ITEM 4 - CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

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

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

There were no changes in the Corporation s internal control over financial reporting during the quarterly period ended June 30, 2016, that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

PART II - OTHER INFORMATION

ACNB CORPORATION

ITEM 1 - LEGAL PROCEEDINGS

As of June 30, 2016, 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, which could have a material adverse effect on ACNB or its subsidiaries or their results of operations. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation or its subsidiaries by governmental authorities.

ITEM 1A - RISK FACTORS

Management has reviewed the risk factors that were previously disclosed in the Annual Report on Form 10-K for the fiscal year ended December 31, 2015. There are no material changes in the risk factors as previously disclosed in the Form 10-K.

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

On November 3, 2008, the Corporation announced a plan to purchase up to 120,000 shares of its outstanding common stock. There were no treasury shares purchased under this plan during the quarter ended June 30, 2016. The maximum number of shares that may yet be purchased under this stock repurchase plan is 57,400.

On May 5, 2009, stockholders approved and ratified the ACNB Corporation 2009 Restricted Stock Plan, effective as of February 24, 2009, in which awards shall not exceed, in the aggregate, 200,000 shares of common stock. As of December 31, 2015, there were 5,673 shares of common stock granted as restricted stock awards to employees of the subsidiary bank. There were 7,435 shares of common stock granted as restricted stock awards to employees of the subsidiary bank during the quarter ended June 30, 2016. The maximum number of shares that may yet be granted under the restricted stock plan is 186,892. The Corporation s Registration Statement under the Securities Act of 1933 on Form S-8 for the ACNB Corporation 2009 Restricted Stock Plan was filed with the Securities and Exchange Commission on January 4, 2013.

On May 5, 2009, stockholders approved and adopted the amendment to the Articles of Incorporation of ACNB Corporation to authorize up to 20,000,000 shares of preferred stock, par value $2.50 per share. As of June 30, 2016, 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 June 30, 2016, there were 115,355 shares of common stock issued through the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan.

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

ITEM 4 - MINE SAFETY DISCLOSURES - NOT APPLICABLE.

ITEM 5 - OTHER INFORMATION - NOTHING TO REPORT.

ITEM 6 - EXHIBITS

The following exhibits are included in this report:

Exhibit 3(i)	Articles of Incorporation of ACNB Corporation, as amended. (Incorporated by reference to Exhibit 3.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 2, 2009.)
Exhibit 3(ii)	Bylaws of ACNB Corporation, as amended. (Incorporated by reference to Exhibit 3.2 of the Registrant s Current Report on Form 8-K, filed with the Commission on February 4, 2013.)
Exhibit 10.1	ACNB Corporation, ACNB Acquisition Subsidiary LLC, and Russell Insurance Group, Inc. Stock Purchase Agreement. (Incorporated by reference to Exhibit 10.2 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
Exhibit 10.2	Salary Continuation Agreement Applicable to Ronald L. Hankey. (Incorporated by reference to Exhibit 10.2 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
Exhibit 10.3	Amended and Restated Executive Supplemental Life Insurance Plan Applicable to Thomas A. Ritter, David W. Cathell, Lynda L. Glass and James P. Helt. (Incorporated by reference to Exhibit 10.3 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Commission on March 6, 2015.)
Exhibit 10.4	Amended and Restated Director Supplemental Life Insurance Plan Applicable to Richard L. Alloway II, Frank Elsner III, Scott L. Kelley, James J. Lott, Robert W. Miller, Donna M. Newell, J. Emmett Patterson, Daniel W. Potts, Marian B. Schultz, David L. Sites, Alan J. Stock and James E. Williams. (Incorporated by reference to Exhibit 10.4 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Commission on March 6, 2015.)
Exhibit 10.5	Amended and Restated Director Deferred Fee Plan Applicable to Richard L. Alloway II, Frank Elsner III, Scott L. Kelley, James J. Lott, Robert W. Miller, Donna M. Newell, J. Emmett Patterson, Marian B. Schultz, David L. Sites, Alan J. Stock and James E. Williams. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on January 6, 2012.)
Exhibit 10.6	ACNB Bank Salary Savings Plan. (Incorporated by reference to Exhibit 10.6 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Commission on March 12, 2010.)
Exhibit 10.7	Group Pension Plan for Employees of ACNB Bank. (Incorporated by reference to Exhibit 10.7 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the Commission on May 4, 2012.)
Exhibit 10.8	Complete Settlement Agreement and General Release made among ACNB Corporation, Adams County National Bank and John W. Krichten effective June 13, 2006. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 15, 2006.)
Exhibit 10.9	Employment Agreement between ACNB Corporation, Adams County National Bank and Thomas A. Ritter dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.9 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
Exhibit 10.10	Employment Agreement between ACNB Corporation, Adams County National Bank and Lynda L. Glass dated as of December 31, 2008. (Incorporated by reference to Exhibit 10.10 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)

Exhibit 10.11	Employment Agreement between ACNB Corporation, Russell Insurance Group, Inc. and Frank C. Russell, Jr. dated as of January 13, 2011. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on January 19, 2011.)
Exhibit 10.12	Employment Agreement between ACNB Corporation, Adams County National Bank and David W. Cathell dated as of April 17, 2009. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 23, 2009.)
Exhibit 10.13	2009 Restricted Stock Plan. (Incorporated by reference to Appendix C of the Registrant s Proxy Statement on Schedule 14A, filed with the Commission on March 25, 2009.)
Exhibit 10.14	Salary Continuation Agreement by and between ACNB Bank and Thomas A. Ritter dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.15	Salary Continuation Agreement by and between ACNB Bank and Lynda L. Glass dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.2 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.16	Salary Continuation Agreement by and between ACNB Bank and David W. Cathell dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.3 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.17	Amended and Restated 2001 Salary Continuation Agreement by and between ACNB Bank and Thomas A. Ritter dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.4 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.18	Amended and Restated 1996 Salary Continuation Agreement by and between ACNB Bank and Lynda L. Glass dated as of March 28, 2012. (Incorporated by reference to Exhibit 99.5 of the Registrant s Current Report on Form 8-K, filed with the Commission on April 3, 2012.)
Exhibit 10.19	Employment Agreement between Adams County National Bank and James P. Helt dated as of April 15, 2009. (Incorporated by reference to Exhibit 10.19 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Commission on March 7, 2014.)
Exhibit 10.20	Salary Continuation Agreement by and between ACNB Bank and James P. Helt dated as of March 28, 2012. (Incorporated by reference to Exhibit 10.20 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Commission on March 7, 2014.)
Exhibit 10.21	ACNB Bank Variable Compensation Plan effective January 1, 2014 and amended July 1, 2016.
Exhibit 10.22	Form of ACNB Bank Variable Compensation Plan Restricted Stock Agreement. (Incorporated by reference to Exhibit 99.2 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 25, 2015.)
Exhibit 10.23	Form of ACNB Bank Variable Compensation Plan Restricted Stock Agreement. (Incorporated by reference to Exhibit 99.3 of the Registrant s Current Report on Form 8-K, filed with the Commission on June 21, 2016.)
Exhibit 11	Statement re Computation of Earnings. (Incorporated by reference to page 7 of this Form 10-Q.)
Exhibit 14	Code of Ethics. (A copy of the Code of Ethics is available under the Corporate Governance Documents section of the Registrant s website at www.acnb.com.)

Exhibit 18	Preferability Letter from ParenteBeard LLC dated as of August 3, 2012. (Incorporated by reference to Exhibit 18 of the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, filed with the Commission on August 3, 2012.)
Exhibit 31.1	Chief Executive Officer Certification of Quarterly Report on Form 10-Q.
Exhibit 31.2	Chief Financial Officer Certification of Quarterly Report on Form 10-Q.
Exhibit 32.1	Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.2	Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

SIGNATURES

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

ACNB CORPORATION (Registrant)

Date: July 29, 2016

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

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