2011 Annual Report

NORTHUMBERLAND BANCORP

NORTHUMBERLAND BANCORP
AUDITED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2011

2011 ANNUAL REPORT
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Northumberland Bancorp

245 Front Street • P.O. Box 271 • Northumberland, PA 17857
(570) 473-3531 Fax (570) 473-9697

March 19, 2012

To our shareholders:

I am very pleased to report that Northumberland Bancorp (the Company), parent company of The Northumberland National Bank (the Bank), earned a record $4,212,000 in 2011, an increase of 32% from $3,181,000 earned in 2010. Assets continued to grow, reaching $450,944,000 on December 31, 2011, an increase of 8.3% from the prior year. This improvement would not have been possible without the efforts of our dedicated officers, committed board and loyal and knowledgeable staff.

Many things have contributed to the increase. Net interest margin (the difference between the interest we earn and what we pay) increased by approximately $870,000, resulting from overall lower rates and a higher level of earnings assets. Overall the net margin percentage increased slightly to 3.02% for 2011. The provision for loan losses declined $450,000 in 2011. Non interest income increased by about $600,000 due to gains on the sale of investment securities, gains on the sale of mortgage loans, and trust department income. These gains were offset by an increase in expenses of about $500,000, of which approximately $200,000 was related to the operational and preoperational costs at the Middleburg Office. The balance of this increase relates to increases in salaries and benefits and general cost increases associated with the Bank's growth. These costs were partially offset by a decrease in FDIC insurance of about $267,000.

The lower provision for loan losses was attributed to the Bank management's evaluation of various factors including the level of classified loans, historic loss factors and certain environmental factors. One of those environmental factors is the level of past due loans. Loans on non-accrual status and past due loans remain low at 1.06% compared to the national peer group average of 3.75%.

The Company remains well capitalized, with tier one capital to average assets increasing from 8.20% in 2010 to 8.37% in 2011. The Company was able to continue this increase in capital while continuing to increase its dividends to shareholders each year for over ten years. During 2011, the quarterly dividend paid to shareholders was increased by 16.7%. On a market value basis the Company's stock has increased significantly. The value of the stock increased from $22 per share in January 2011 and is currently being traded at $28 per share.

In September, the Bank opened its office in Middleburg, Pennsylvania. The office has been well received, with a significant level of loan activity as well as steady growth in deposit accounts.

During 2012, the Bank expects to implement a mobile banking product that will enhance the experience of our customers who wish to bank with us through their smart phones. The Bank continues to evaluate new technology in order to improve our services to our customers.

The Bank continued its tradition of service to the community. During 2012, the Bank contributed over $160,000 to more than 80 community organizations. In addition, we are proud of the fact that our employees volunteer their time to over 50 community organizations.

The trust and value that our customers and you, our valued shareholders, place on our relationships continue to serve us well. We look for continued growth in assets and earnings as we move through 2012. Thank you for being a shareholder of Northumberland Bancorp and for your continued support.

Sincerely,

J. Donald Steele, Jr.
Chairman and President

SNODGRASS
CERTIFIED PUBLIC ACCOUNTANTS
AND CONSULTANTS

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Stockholders
Northumberland Bancorp

We have audited the accompanying consolidated balance sheet of Northumberland Bancorp and subsidiary (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Northumberland Bancorp and subsidiary as of December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

S.R. Snodgrass, A.C.

Wexford, Pennsylvania
March 19, 2012

NORTHUMBERLAND BANCORP
CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2011 AND 2010

(Amounts in thousands except per share data)

	2011	2010
ASSETS		
Cash and due from banks	$ 1,945	$ 1,916
Interest-bearing deposits in other banks	10,768	5,995
Federal funds sold	-	2,000
Total cash and cash equivalents	12,713	9,911
Investment securities available for sale	170,065	138,430
Investment securities held to maturity (fair value of $4,149 and $3,929)	4,099	3,868
Total investment securities	174,164	142,298
Loans held for sale	1,166	7,610
Loans	251,037	246,470
Less allowance for loan losses	2,538	2,541
Net loans	248,499	243,929
Premises and equipment	8,780	7,715
Prepaid federal deposit insurance	886	1,190
Accrued interest and other assets	4,736	3,869
TOTAL ASSETS	$ 450,944	$ 416,522
LIABILITIES		
Deposits:		
Non-interest-bearing demand	$ 35,116	$ 30,340
Interest-bearing demand	148,596	129,381
Savings	61,500	55,151
Time $100,000 and over	66,283	60,954
Other time	93,608	99,373
Total deposits	405,103	375,199
Short-term borrowings	-	422
Other borrowings	5,072	5,072
Accrued interest and other liabilities	2,616	947
TOTAL LIABILITIES	412,791	381,640
STOCKHOLDERS' EQUITY		
Common stock, par value $0.10; 5,000,000 shares authorized, 1,502,500 shares issued	150	150
Capital surplus	3,832	3,832
Retained earnings	35,914	32,396
Accumulated other comprehensive income	282	529
	40,178	36,907
Treasury stock, at cost (166,978 shares)	(2,025)	(2,025)
TOTAL STOCKHOLDERS' EQUITY	38,153	34,882
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 450,944	$ 416,522

See accompanying notes to the consolidated financial statements.

NORTHUMBERLAND BANCORP
CONSOLIDATED STATEMENT OF INCOME
FOR YEARS ENDED DECEMBER 31, 2011 AND 2010

(Amounts in thousands except per share data)

	2011	2010
INTEREST AND DIVIDEND INCOME		
Interest and fees on loans:		
Taxable	$ 14,368	$ 14,123
Tax-exempt	30	34
Federal funds sold	3	6
Interest on interest-bearing deposits in other banks	20	16
Interest and dividends on investment securities:		
Taxable interest	1,893	2,222
Tax-exempt interest	1,527	1,328
Dividends	15	11
Total interest and dividend income	17,856	17,740
INTEREST EXPENSE		
Deposits	5,722	6,412
Short-term borrowings	-	1
Other borrowings	269	332
Total interest expense	5,991	6,745
NET INTEREST INCOME	11,865	10,995
Provision for loan losses	250	700
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,615	10,295
NONINTEREST INCOME		
Service charges on deposit accounts	760	718
Trust services income	582	540
Investment securities gains, net	384	180
Gain on sale of loans	878	474
Other income	427	500
Total noninterest income	3,031	2,412
NONINTEREST EXPENSE		
Salaries and employee benefits	4,873	4,526
Occupancy expense, net	581	567
Equipment expense	623	524
Data processing	387	366
Shares tax	208	202
Federal deposit insurance expense	332	599
Other expense	2,003	1,736
Total noninterest expense	9,007	8,520
Income before income taxes	5,639	4,187
Income taxes	1,427	1,006
NET INCOME	$ 4,212	$ 3,181
EARNINGS PER SHARE	$ 3.15	$ 2.37
WEIGHTED-AVERAGE SHARES OUTSTANDING	1,335,522	1,342,696

See accompanying notes to the consolidated financial statements.

NORTHUMBERLAND BANCORP
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
FOR YEARS ENDED DECEMBER 31, 2011 AND 2010

(Amounts in thousands except per share data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total	Comprehensive Income (Loss)
Balance, December 31, 2009	$ 150	$ 3,832	$ 29,832	$ 213	$ (1,680)	$ 32,347	
Net income			3,181			3,181	$ 3,181
Other comprehensive income:							
Change in unrecognized pension costs, net of taxes of $27				(52)		(52)	(52)
Unrealized gain on available-for-sale securities, net of reclassification adjustment, net of taxes of $190				368		368	368
Comprehensive income							$ 3,497
Purchases of treasury stock (17,276 shares)					(345)	(345)	
Dividends declared ($.46 per share)			(617)			(617)	
Balance, December 31, 2010	150	3,832	32,396	529	(2,025)	34,882	
Net income			4,212			4,212	$ 4,212
Other comprehensive loss:							
Change in unrecognized pension costs, net of taxes of $469				(910)		(910)	(910)
Unrealized gain on available-for-sale securities, net of reclassification adjustment, net of taxes of $342				663		663	663
Comprehensive income							$ 3,965
Dividends declared ($.52 per share)			(694)			(694)	
Balance, December 31, 2011	$ 150	$ 3,832	$ 35,914	$ 282	$ (2,025)	$ 38,153	

	2011	2010
Components of accumulated other comprehensive income (loss):		
Change in net unrealized gains on available-for-sale securities	$ 916	$ 487
Realized gains included in net income, net of taxes of $131 and $61	(253)	(119)
Change in unrecognized pension costs	(910)	(52)
Total	$ (247)	$ 316

See accompanying notes to the consolidated financial statements.

NORTHUMBERLAND BANCORP
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2011 AND 2010

(Amounts in thousands except per share data)

	2011	2010
OPERATING ACTIVITIES		
Net income	$ 4,212	$ 3,181
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Provision for loan losses	250	700
Depreciation, amortization, and accretion, net	2,350	1,440
Proceeds from sale of loans held for sale	32,912	18,995
Net realized gain on sale of loans	(878)	(474)
Originations of residential loans held for sale	(25,590)	(25,626)
Investment securities gains, net	(384)	(180)
Deferred income taxes	289	32
Decrease in prepaid federal deposit insurance	304	560
Increase in accrued interest receivable	(240)	(123)
Decrease in accrued interest payable	(23)	(70)
Other, net	(397)	(227)
Net cash provided by (used for) operating activities	12,805	(1,792)
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from sales	21,285	20,720
Proceeds from maturities or redemptions	30,736	32,294
Purchases	(83,736)	(54,000)
Investment securities held to maturity:		
Proceeds from sales	167	-
Proceeds from maturities or redemptions	1,815	3,960
Purchases	(2,247)	(152)
Increase in loans, net	(2,268)	(9,251)
Purchases of loans	(3,746)	(17,724)
Purchases of premises and equipment	(1,553)	(547)
Purchases of regulatory stock	(341)	-
Redemption of regulatory stock	150	91
Proceeds from sale of real estate owned	947	276
Net cash used for investing activities	(38,791)	(24,333)
FINANCING ACTIVITIES		
Net increase in deposits	29,904	28,186
Net decrease in short-term borrowings	(422)	(114)
Repayment of other borrowings	-	(2,202)
Cash dividends paid	(694)	(617)
Purchase of treasury stock	-	(345)
Net cash provided by financing activities	28,788	24,908
Increase (decrease) in cash and cash equivalents	2,802	(1,217)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	9,911	11,128
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 12,713	$ 9,911

See accompanying notes to the consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of significant accounting and reporting policies applied in the presentation of the accompanying consolidated financial statements follows:

Nature of Operations and Basis of Presentation

Northumberland Bancorp (the "Company") is a Pennsylvania corporation and is registered under the Bank Holding Company Act. The Company was organized as the holding company of its wholly owned subsidiary, The Northumberland National Bank (the "Bank"). The Bank is a nationally chartered commercial bank located in Northumberland, Pennsylvania. The Bank's service area includes portions of Northumberland, Snyder, Union, and Montour counties in Pennsylvania. The Company and the Bank derive substantially all of their income from banking and bank-related services, which includes interest earnings on commercial, commercial mortgage, residential real estate, and consumer loan financing as well as interest earnings on investment securities and deposit and trust services to its customers. The Company is supervised by the Federal Reserve Board, while the Bank is subject to regulation and supervision by the Office of the Comptroller of the Currency.

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, the Bank. Intercompany activity has been eliminated in consolidation. The investment in subsidiary on the parent company's financial statements is carried at the parent company's equity in the underlying net assets of the Bank.

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and with general practice within the banking industry. In preparing the financial statements, management is required to make certain estimates and assumptions that affect the reported amounts of assets and liabilities as of the Consolidated Balance Sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Investment Securities

Investment securities are classified at the time of purchase, based on management's intention and ability, as securities held to maturity or securities available for sale. Debt securities acquired with the intent and ability to hold to maturity are stated at cost adjusted for amortization of premium and accretion of discount that are computed using the level yield method and recognized as adjustments of interest income. Certain other debt securities have been classified as available for sale to serve principally as a source of liquidity. Unrealized holding gains and losses for available-for-sale securities are reported as a separate component of stockholders' equity, net of tax, until realized. Realized securities gains and losses are computed using the specific identification method. Interest and dividends on investment securities are recognized as income when earned.

Securities are periodically reviewed for other-than-temporary impairment based upon a number of factors, including, but not limited to, the length of time and extent to which the market value has been less than cost, the financial condition of the underlying issuer, the ability of the issuer to meet contractual obligations, the likelihood of the security's ability to recover any decline in its market value, and whether or not the Company intends to sell the security or whether it's more likely than not that the Company would be required to sell the security before its anticipated recovery in market value. A decline in value that is considered to be other than temporary is recorded as a loss within noninterest income in the Consolidated Statement of Income.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Federal Home Loan Bank Stock

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

The FHLB had incurred losses in 2009 and for parts of 2010 due primarily to other-than-temporary impairment credit losses on its private-label mortgage-backed securities portfolio. These securities were the most affected by the extreme economic conditions in place during the previous several years. As a result, the FHLB had suspended the payment of dividends and limited the amount of excess capital stock repurchases. The FHLB has reported net income for both the fourth quarter and the year ended December 31, 2011, and has declared a 0.10 percent annualized dividend to its shareholders effective February 23, 2012. While the FHLB has not committed to regular dividend payments or future limited repurchases of excess capital stock, it will continue to monitor the overall financial performance of the FHLB in order to determine the status of limited repurchases of excess capital stock or dividends in the future. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. More consideration was given to the long-term prospects for the FHLB as opposed to the recent stress caused by the extreme economic conditions the world is facing. Management also considered that the FHLB maintains regulatory capital ratios in excess of all regulatory capital requirements, liquidity appears adequate, new shares of FHLB stock continue to change hands at the $100 par value, and the resumption of dividends.

Loans Held For Sale and Loans Serviced

Loans held for sale are carried at the lower of cost or estimated fair value, as determined on an aggregate basis. Gains and losses on sales of loans held for sale are recognized on settlement dates and are determined by the difference between the sale proceeds and the carrying value of loans. All sales are made with limited recourse. Loans held for sale were $1,166,000 and $7,610,000 at December 31, 2011 and 2010, respectively. At December 31, 2011 and 2010, the amounts of loans serviced by the Company for the benefit of others were $60,746,000 and $39,739,000, respectively.

Loans

Loans are reported at their principal amount, net of unearned income and the allowance for loan losses. Interest income on all loans is recognized on an accrual basis. Nonrefundable loan fees and certain direct costs are deferred and amortized over the life of the loans using the interest method. The amortization is reflected as an interest yield adjustment, and the deferred portion of the net fees and costs is reflected as part of the loan balance. Accrual of interest is discontinued when, in the opinion of management, reasonable doubt exists as to the collectibility of additional interest. Loans are returned to accrual status when past-due interest is collected and the collection of principal is probable.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses

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

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

Mortgage loans on one-to-four family properties and all consumer loans are large groups of smaller-balance homogeneous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis taking into consideration all circumstances surrounding the loan and the borrower including the length of the delay, the borrower's prior payment record, and the amount of shortfall in relation to the principal and interest owed.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets, which range from 3 to 20 years for furniture, fixtures, and equipment and 15 to 50 years for buildings and leasehold improvements. Expenditures for maintenance and repairs are charged against income as incurred. Costs of major additions and improvements are capitalized.

Mortgage Servicing Rights ("MSRs")

The Company has agreements for the express purpose of selling loans in the secondary market. The Company maintains servicing rights for certain loans. Originated MSRs are recorded by allocating total costs incurred between the loan and servicing rights based on their relative fair values. MSRs are amortized in proportion to the estimated servicing income over the estimated life of the servicing portfolio. Annually, the Company performs an impairment review of the MSRs and recognizes impairment through a valuation account. MSRs are a component of other assets on the Consolidated Balance Sheet.

(Amounts in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Real Estate Owned

Real estate owned acquired in settlement of foreclosed loans is carried as a component of other assets at the lower of cost or fair value minus estimated cost to sell. Direct cost incurred in the foreclosure process and subsequent holding costs incurred on such properties are recorded as expenses of current operations.

Advertising Costs

Advertising costs are expensed as the costs are incurred. Advertising expenses amounted to $145,000 and $141,000 for 2011 and 2010, respectively.

Income Taxes

The Company and the Bank file a consolidated federal income tax return. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax basis of assets and liabilities using the enacted marginal tax rates. Deferred income tax expenses or benefits are based on the changes in the deferred tax asset or liability from period to period.

Pension Plan

The Bank has a noncontributory defined benefit pension plan that covers all eligible employees. Benefits are based upon years of service, the employee's compensation, and age at retirement. The Bank's contribution is actuarially determined and is intended to meet the current and projected obligations of the plan.

Trust Assets and Income

Assets held by the Bank in a fiduciary or agency capacity for its customers are not included in the accompanying financial statements, since such items are not assets of the Bank. In accordance with banking industry practice, Trust Department income is recognized on the cash basis and is not materially different than if it was reported on the accrual basis.

Comprehensive Income (Loss)

The Company is required to present comprehensive income (loss) and its components in a full set of general-purpose financial statements for all periods presented. Other comprehensive income (loss) is composed of net unrealized holding gains or losses on its available-for-sale investment and mortgage-backed securities portfolio, as well as changes in unrecognized pension cost.

The components of accumulated other comprehensive income, net of tax, as of year-end were as follows:

	2011	2010
Net unrealized gain on securities available for sale	$ 2,057	$ 1,394
Net unrecognized pension cost	(1,775)	(865)
Total	$ 282	$ 529

Earnings Per Share

The Company currently maintains a simple capital structure; therefore, there are no dilutive effects on earnings per share. As such, earnings per share are calculated using the weighted-average number of shares outstanding for the periods.

(Amounts in thousands except per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash Flow Information

The Company has defined cash and cash equivalents as those amounts included in the Consolidated Balance Sheet captions “Cash and due from banks,” “Interest-bearing deposits in other banks,” and “Federal funds sold” with original maturities of 90 days or less.

	2011	2010
Cash paid during the year for:		
Interest	$ 6,014	$ 6,815
Income taxes	933	1,126
Noncash investing transactions:		
Transfer of loans to real estate earned	846	308

Reclassification of Comparative Amounts

Certain comparative amounts for the prior year have been reclassified to conform to current-year classifications. Such reclassifications had no effect on stockholders’ equity or net income.

NOTE 2 - INVESTMENT SECURITIES

The amortized cost and fair values of investment securities are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2011 AVAILABLE FOR SALE				
U.S. government agency securities	$ 1,000	$ -	$ -	$ 1,000
Obligations of states and political subdivisions	50,440	2,132	(22)	52,550
Mortgage-backed securities in government-sponsored entities	114,900	1,238	(220)	115,918
Corporate debt securities	500	-	(33)	467
Subtotal	166,840	3,370	(275)	169,935
Equity securities in financial institutions	108	22	-	130
Total	$ 166,948	$ 3,392	$ (275)	$ 170,065

(Amounts in thousands except per share data)

NOTE 2 - INVESTMENT SECURITIES (Continued)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2010 AVAILABLE FOR SALE				
U.S. government agency securities	$ 1,000	$ -	$ -	$ 1,000
Obligations of states and political subdivisions	41,020	788	(147)	41,661
Mortgage-backed securities in government-sponsored entities	94,199	1,721	(265)	95,655
Subtotal	136,219	2,509	(412)	138,316
Equity securities in financial institutions	99	15	-	114
Total	$ 136,318	$ 2,524	$ (412)	$ 138,430

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2011 HELD TO MATURITY				
Obligations of states and political subdivisions	$ 3,598	$ 48	$ (1)	$ 3,645
Corporate debt securities	501	3	-	504
Total	$ 4,099	$ 51	$ (1)	$ 4,149

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2010 HELD TO MATURITY				
Obligations of states and political subdivisions	$ 2,482	$ 37	$ -	$ 2,519
Corporate debt securities	1,386	25	(1)	1,410
Total	$ 3,868	$ 62	$ (1)	$ 3,929

(Amounts in thousands except per share data)

NOTE 2 - INVESTMENT SECURITIES (Continued)

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

	2011					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Obligations of states and political subdivisions	$ 2,768	$ (22)	$ 476	$ (1)	$ 3,244	$ (23)
Mortgage-backed securities in government-sponsored entities	25,891	(164)	9,453	(56)	35,344	(220)
Corporate debt securities	467	(33)	-	-	467	(33)
Total	$ 29,126	$ (219)	$ 9,929	$ (57)	$ 39,055	$ (276)

	2010					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Obligations of states and political subdivisions	$ 7,965	$ (147)	$ 4,238	$ -	$ 12,203	$ (147)
Mortgage-backed securities in government-sponsored entities	14,577	(169)	13,020	(96)	27,597	(265)
Corporate debt securities	500	(1)	-	-	500	(1)
Total	$ 23,042	$ (317)	$ 17,258	$ (96)	$ 40,300	$ (413)

The Company reviews its position quarterly and has asserted that at December 31, 2011 and 2010, the declines outlined in the above table represent temporary declines and the Company does not intend to sell and does not believe they will be required to sell these securities before recovery of their cost basis, which may be at maturity. There were 70 positions that were temporarily impaired at December 31, 2011. The Company has concluded that the unrealized losses disclosed above are not other than temporary but are the result of interest rate changes, sector credit ratings changes, or Company-specific ratings changes that are not expected to result in the non-collection of principal and interest during the period.

(Amounts in thousands except per share data)

NOTE 2 - INVESTMENT SECURITIES (Continued)

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

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 3,169	$ 3,178	$ 872	$ 879
Due after one year through five years	23,623	24,451	3,227	3,270
Due after five years through ten years	92,228	94,394	-	-
Due after ten years	47,820	47,912	-	-
Total	$ 166,840	$ 169,935	$ 4,099	$ 4,149

Proceeds from the sales of available-for-sale securities during 2011 amounted to $21,285,000 resulting in gross gains and gross losses of $435,000 and $52,000, respectively. Proceeds from the sales of available-for-sale securities during 2010 amounted to $20,720,000 resulting in gross gains and gross losses of $270,000 and $87,000, respectively.

The Company sold a $166,000 held-to-maturity security during 2011. The held-to-maturities securities portfolio is not considered tainted because there was evidence that there was significant deterioration in the issuer's creditworthiness. The sale resulted in a gain of $1,000.

During 2010, the Company recorded $3,000 in other-than-temporary impairment charges on investment securities.

Investment securities with fair values of $77,605,000 and $67,515,000 at December 31, 2011 and 2010, respectively, were pledged to secure public deposits and other purposes as required by law.

NOTE 3 - LOANS

Major classifications of loans are summarized as follows:

	2011	2010
Commercial	$ 53,013	$ 47,331
Commercial real estate	41,326	36,168
Residential real estate	151,860	157,276
Consumer	4,838	5,695
	251,037	246,470
Less allowance for loan losses	2,538	2,541
Net loans	$ 248,499	$ 243,929

The Company grants residential, commercial, and consumer loans to customers throughout its trade area, which is concentrated in North Central Pennsylvania. Although the Company has a diversified loan portfolio at

(Amounts in thousands except per share data)

NOTE 3 - LOANS (Continued)

December 31, 2011 and 2010, a substantial portion of its debtors' ability to honor their loan agreements is dependent upon the economic stability of its immediate trade area.

Loans of $60,000 or more extended to directors and executive officers of the Company, members of their immediate families, and companies in which they are principal owners (i.e., at least 10 percent) were indebted to the Company at December 31, 2011 and 2010. A summary of the activity regarding these loans for 2011 follows:

2010	Advances	Repayments	2011
$ 1,131	$ 100	$ 283	$ 948

NOTE 4 - ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses by portfolio segment are as follows:

2011	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 693	$ 416	$ 1,342	$ 66	$ 24	$ 2,541
Charge-offs	(392)	-	(237)	(2)	-	(631)
Recoveries	210	-	166	2	-	378
Provision	34	30	(70)	(20)	276	250
Ending balance	$ 545	$ 446	$ 1,201	$ 46	$ 300	$ 2,538

2010	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Beginning balance	$ 762	$ 78	$ 1,358	$ 98	$ 33	$ 2,329
Charge-offs	(138)	-	(337)	(43)	-	(518)
Recoveries	14	-	4	12	-	30
Provision	55	338	317	(1)	(9)	700
Ending balance	$ 693	$ 416	$ 1,342	$ 66	24	$ 2,541

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, commercial real estate loans, residential real estate loans, and consumer loans. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over a two-year period for all portfolio segments. Certain qualitative factors are then added to the historical allocation percentage to get the adjusted factor to be applied to nonclassified loans. The following qualitative factors are analyzed for each portfolio segment:

- Levels of and trends in delinquencies
- Trends in volume and terms
- Trends in credit quality ratings
- Changes in management and lending staff
- Economic trends
- Concentrations of credit

(Amounts in thousands except per share data)

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (Continued)

These qualitative factors are reviewed each quarter and adjusted based upon relevant changes within the portfolio. During 2011 and 2010, the qualitative factors for residential real estate loans increased slightly while the factors for the other portfolio segments remained the same as in the prior year.

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of $2,538,000 and $2,541,000 adequate to cover loan losses inherent in the loan portfolio, at December 31, 2011 and 2010. The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2011 and 2010:

	2011					
	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Individually evaluated for impairment	$ 18	$ 2	$ -	$ -	$ -	$ 20
Collectively evaluated for impairment	527	444	1,201	46	300	2,518
Total	$ 545	$ 446	$ 1,201	$ 46	$ 300	$ 2,538
Loans:						
Individually evaluated for impairment	$ 55	$ 101	$ -	$ -	$ -	$ 156
Collectively evaluated for impairment	52,958	41,225	151,860	4,838	-	250,881
Total	$ 53,013	$ 41,326	$ 151,860	$ 4,838	$ -	$ 251,037

	2010					
	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Individually evaluated for impairment	$ 321	$ 29	$ -	$ -	$ -	$ 350
Collectively evaluated for impairment	372	387	1,342	66	24	2,191
Total	$ 693	$ 416	$ 1,342	$ 66	$ 24	$ 2,541
Loans:						
Individually evaluated for impairment	$ 543	$ 65	$ -	$ -	$ -	$ 608
Collectively evaluated for impairment	46,788	36,103	157,276	5,695	-	245,862
Total	$ 47,331	$ 36,168	$ 157,276	$ 5,695	$ -	$ 246,470

Credit Quality Information

The Company's internally assigned grades are as follows:

Pass loans are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral. There are three sub-grades within the Pass category to further distinguish the loan.

Special Mention loans are loans for which a potential weakness or risk exists, which could cause a more serious problem if not corrected.

(Amounts in thousands except per share data)

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Information (Continued)

Substandard loans have a well-defined weakness based on objective evidence and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful loans have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances.

Loss loans are considered uncollectible, or of such value that continuance as an asset is not warranted.

The following tables represent credit exposures by internally assigned grades for the years ended December 31, 2011 and 2010. The grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Company's internal credit risk grading system is based on experiences with similarly graded loans.

	2011				
	Obligations of State and Political Subdivisions	Other Commercial Loans	Loans for Investment Properties	Other Commercial Real Estate Loans	Total
Pass	$ 21,153	$ 26,644	$ 19,969	$ 20,841	$ 88,607
Special Mention	-	1,636	275	-	1,911
Substandard	-	3,580	70	171	3,821
Doubtful	-	-	-	-	-
Loss	-	-	-	-	-
Ending balance	$ 21,153	$ 31,860	$ 20,314	$ 21,012	$ 94,339

	2010				
	Obligations of State and Political Subdivisions	Other Commercial Loans	Loans for Investment Properties	Other Commercial Real Estate Loans	Total
Pass	$ 18,140	$ 25,979	$ 18,204	$ 17,057	$ 79,380
Special Mention	-	1,099	462	340	1,901
Substandard	-	1,816	65	40	1,921
Doubtful	-	297	-	-	297
Loss	-	-	-	-	-
Ending balance	$ 18,140	$ 29,191	$ 18,731	$ 17,437	$ 83,499

The following tables present performing and nonperforming residential real estate and consumer loans based on payment activity for the year ended December 31, 2011 and 2010. Payment activity is reviewed by management on a monthly basis to determine how loans are performing. Loans are considered to be nonperforming when they become 90 days past due or are placed on nonaccrual.

(Amounts in thousands except per share data)

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (Continued)

	2011			
	First Mortgages	Home Equity Loans	Consumer	Total
Performing	$ 132,916	$ 18,572	$ 4,838	$ $156,326
Nonperforming	351	21	-	372
Total	$ 133,267	$ 18,593	$ 4,838	$ $156,698

	2010			
	First Mortgages	Home Equity Loans	Consumer	Total
Performing	$ 135,620	$ 20,101	$ 5,695	$ $161,416
Nonperforming	1,519	36	-	1,555
Total	$ 137,139	$ 20,137	$ 5,695	$ $162,971

Following are tables which include an aging analysis of the recorded investment of past due loans as of December 31, 2011 and 2010.

	2011					
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total
Commercial						
Obligations of state and political subdivisions	$ -	$ -	$ -	$ -	$ 21,153	$ 21,153
Other commercial loans	86	28	16	130	31,730	31,860
Commercial real estate						
Loans for investment property	119	-	70	189	20,125	20,314
Other commercial real estate loans	-	102	70	172	20,840	21,012
Residential mortgage loans						
First mortgages	1,351	233	197	1,781	131,486	133,267
Home equity loans	180	-	21	201	18,392	18,593
Consumer	33	1	-	34	4,804	4,838
Total	$ 1,769	$ 364	$ 374	$ 2,507	$ 248,530	$ 251,037

(Amounts in thousands except per share data)

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (Continued)

	2010					
	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total
Commericial						
Obligations of state and political subdivisions	$ -	$ -	$ -	$ -	$ 18,140	$ 18,140
Other commercial loans	354	297	-	651	28,540	29,191
Commercial real estate						
Loans for investment property	11	-	64	75	18,656	18,731
Other commercial real estate loans	-	-	40	40	17,397	17,437
Residential mortgage loans						
First mortgages	1,557	109	1,440	3,106	134,033	137,139
Home equity loans	221	32	35	288	19,849	20,137
Consumer	72	4	-	76	5,619	5,695
Total	$ 2,215	$ 442	$ 1,579	$ 4,236	$ 242,234	$ 246,470

Impaired Loans

Management evaluates commercial loans and commercial real estate loans which are 90 days or more past due and considers them to be impaired. Loans rated Substandard or Doubtful are also evaluated for impairment. These loans are analyzed to determine whether it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees, or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

(Amounts in thousands except per share data)

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans (Continued)

The following tables include the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable, as of and for the year ending December 31:

	2011				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Obligations of state and political subdivisions	$ -	$ -	$ -	$ -	$ -
Other commercial loans	37	37	-	38	-
Commercial real estate:					
Loans for investment properties	-	-	-	-	-
Other commercial real estate loans	26	26	-	13	2
With an allowance recorded:					
Commercial:					
Obligations of state and political subdivisions	-	-	-	-	-
Other commercial loans	18	18	18	290	1
Commercial real estate:					
Loans for investment properties	-	-	-	33	-
Other commercial real estate loans	75	75	2	37	6
	$ 156	$ 156	$ 20	$ 411	$ 9

(Amounts in thousands except per share data)

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans (Continued)

	2010				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial:					
Obligations of state and political subdivisions	$ -	$ -	$ -	$ -	$ -
Other commercial loans	-				
Commercial real estate:					
Loans for investment properties	-	-	-	-	-
Other commercial real estate loans	-	-	-	-	-
With an allowance recorded:					
Commercial:	-	-	-	-	-
Obligations of state and political subdivisions	-	-	-	-	-
Other commercial loans	543	543	321	563	19
Commercial real estate:					
Loans for investment properties	65	65	29	64	-
Other commercial real estate loans	-	-	-	-	-
	$ 608	$ 608	$ 350	$ 627	$ 19

Nonaccrual Loans

Loans are considered for nonaccrual status upon 90 days delinquency. When a loan is placed in nonaccrual status, previously accrued but unpaid interest is deducted from interest income.

(Amounts in thousands except per share data)

NOTE 4 - ALLOWANCE FOR LOAN LOSSES (Continued)

Nonaccrual Loans (Continued)

The following tables present loans that are on nonaccrual status and that are 90 days delinquent and still accruing interest by portfolio segment as of December 31:

	2011	
	Nonaccrual	Past due 90 days or more and still accruing
Commercial:		
Obligations of state and political subdivisions	$ -	$ -
Other commercial loans	-	16
Commercial real estate:		
Loans for investment properties	70	-
Other commercial real estate loans	37	33
Residential mortgage loans:		
First mortgages	311	40
Home equity loans	3	18
Consumer loans	-	-
	$ 421	$ 107

	2010	
	Nonaccrual	Past due 90 days or more and still accruing
Commercial:		
Obligations of state and political subdivisions	$ -	$ -
Other commercial loans	297	-
Commercial real estate:		
Loans for investment properties	65	-
Other commercial real estate loans	40	-
Residential mortgage loans:		
First mortgages	1,400	118
Home equity loans	31	5
Consumer loans	-	-
	$ 1,833	$ 123

Interest income on nonaccrual loans not recognized during 2011 and 2010 were $40,000 and $280,000, respectively.

(Amounts in thousands except per share data)

NOTE 5 - PREMISES AND EQUIPMENT

Major classifications of premises and equipment are summarized as follows:

	2011	2010
Land and improvements	$ 1,458	$ 1,444
Buildings and improvements	7,635	6,702
Furniture, fixtures, and equipment	3,431	2,825
	12,524	10,971
Less accumulated depreciation	3,744	3,256
Total	$ 8,780	$ 7,715

Depreciation expense for the years ended December 31, 2011 and 2010, was $488,000 and $434,000, respectively.

NOTE 6 - DEPOSITS

Time deposits at December 31, 2011, mature $66,175,000, $25,628,000, $23,059,000, $29,685,000, and $15,344,000 during 2012, 2013, 2014, 2015, and 2016 and after, respectively.

Time deposits include certificates of deposit in denominations of $100,000 or more. Such deposits aggregated $66,283,000 and $60,954,000 at December 31, 2011 and 2010, respectively. Maturities on time deposits of $100,000 or more at December 31, 2011, are as follows:

Within three months	$ 7,080
Three through six months	5,853
Six through twelve months	10,812
Over twelve months	42,538
Total	$ 66,283

NOTE 7 - SHORT-TERM BORROWINGS

The outstanding balances and related information of short-term borrowings, which includes FHLB borrowings, sweep arrangements, and securities sold under agreements to repurchase, are summarized as follows:

	2011	2010
Balance at year-end	$ -	$ 422
Average balance outstanding	52	649
Maximum month-end balance	589	1,027
Weighted-average rate at year-end	0.00 %	0.25 %
Weighted-average rate during the year	0.27 %	0.19 %

Average balances outstanding during the year represent daily average balances, and average interest rates represent interest expense divided by the related average balance.

(Amounts in thousands except per share data)

NOTE 8 - OTHER BORROWINGS

The following table sets forth information concerning other borrowings with the FHLB:

Description	Maturity	Weighted-Average Interest Rate	Stated Interest Rate Range From	Stated Interest Rate Range To	At December 31, 2011	At December 31, 2010
Fixed	5/7/2012	7.84%	7.84%	7.84%	$ 72	$ 72
Convertible	6/6/2012	5.20%	5.20%	5.20%	5,000	5,000
					$ 5,072	$ 5,072

The Bank has a five-year "Convertible Select" fixed commitment advance arrangement with the FHLB maturing June 6, 2012. The rates on these borrowings may be reset at the FHLB's discretion on a quarterly basis based on the three-month LIBOR rate after their initial fixed rate period. The Bank may repay these loans on the reset date without a prepayment fee.

The Bank maintains a credit arrangement which includes a revolving line of credit with the FHLB. Under this credit arrangement, the Bank has a remaining borrowing capacity of approximately $116.2 million at December 31, 2011, which is subject to annual renewal and typically incurs no service charges. Under terms of a blanket agreement, collateral for the FHLB borrowings must be secured by certain qualifying assets of the Bank that consist principally of first mortgage loans.

NOTE 9 - INCOME TAXES

The provision for income taxes consists of:

	2011	2010
Current	$ 1,138	$ 974
Deferred	289	32
Total	$ 1,427	$ 1,006

(Amounts in thousands except per share data)

NOTE 9 - INCOME TAXES (Continued)

The tax effects of deductible and taxable temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities respectively at December 31 are as follows:

	2011	2010
Deferred tax assets:		
Allowance for loan losses	$ 764	$ 789
Accrued pension obligation	915	445
Other	6	65
Total gross deferred tax assets	1,685	1,299
Deferred tax liabilities:		
Premises and equipment	525	348
Investment accretion	4	7
Unrealized gain on investment securities	1,060	718
Prepaid pension costs	322	285
Loan origination fees and costs	139	145
Total gross deferred tax liabilities	2,050	1,503
Net deferred tax liabilities	$ (365)	$ (204)

No valuation allowance was established at December 31, 2011 and 2010, in view of the Company's ability to carryback to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Company's earnings potential.

The following is a reconciliation of the federal statutory rate and the Company's effective income tax rate for the years ended December 31:

	2011		2010	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	$ 1,917	34.0 %	$ 1,424	34.0 %
Effect of tax-free income	(542)	(9.6)	(467)	(11.2)
Nondeductible interest expense	49	0.8	47	1.1
Other, net	3	0.1	2	0.1
Actual tax expense and effective rate	$ 1,427	25.3 %	$ 1,006	24.0 %

NOTE 9 - INCOME TAXES (Continued)

The Company prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the Consolidated Statement of Income. With few exceptions, the Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2008.

NOTE 10 - COMMITMENTS

In the normal course of business, the Company makes various commitments that are not reflected in the accompanying consolidated financial statements. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheet. The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments is represented by the contractual amounts as disclosed. Losses, if any, are charged to the allowance for loan losses. The Company minimizes its exposure to credit loss under these commitments by subjecting them to credit approval, review procedures, and collateral requirements as deemed necessary.

The off-balance sheet commitments consisted of the following:

	2011	2010
Commitments to extend credit	$ 23,533	$ 24,021
Standby letters of credit	3,596	6,340

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. These commitments are composed primarily of available commercial lines of credit and mortgage loan commitments. The Company uses the same credit policies in making loan commitments and conditional obligations as it does for on-balance sheet instruments. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, as deemed necessary, is based upon management's credit evaluation in compliance with the Company's lending policy guidelines. Customers use credit commitments to ensure funds will be available for working capital purposes, for capital expenditures, and to ensure access to funds at specified terms and conditions.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Performance letters of credit represent conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These instruments are issued primarily to support bid- or performance-related contracts. The coverage period for these instruments is typically a one-year period with an annual renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized over the coverage period. For secured letters of credit, the collateral is typically Company deposit instruments or customer business assets.

(Amounts in thousands except per share data)

NOTE 11 - PENSION PLAN

The Bank sponsors a defined benefit pension plan covering substantially all employees and officers. The plan calls for benefits to be paid to eligible employees at retirement, based primarily upon years of service with the Bank and compensation rates during employment. The Bank's funding policy is to make annual contributions, if needed, based upon the funding formula developed by the plan's actuary.

The following table sets forth the obligation and funded status as of December 31:

	2011	2010
Change in benefit obligation		
Benefit obligation at beginning of year	$ 4,246	$ 3,486
Service cost	399	342
Interest cost	238	205
Change in assumptions	1,078	164
Actuarial gains	101	132
Benefits paid	(96)	(83)
Benefit obligation at end of year	5,966	4,246
Change in plan assets		
Fair value of plan assets at beginning of year	3,801	3,030
Adjustment to market value at beginning of year	24	14
Actual return on plan assets	22	390
Employer contribution	500	450
Benefits paid	(96)	(83)
Fair value of plan assets at end of year	4,251	3,801
Funded status	$ (1,715)	$ (445)

	2011	2010
Amounts not yet recognized as a component of net periodic pension cost:		
Amounts recognized in accumulated other comprehensive income consists of:		
Net loss	$ 2,690	$ 1,310
Total	$ 2,690	$ 1,310

The accumulated benefit obligation for the defined benefit pension plan was $4,722,000 and $3,438,000 at December 31, 2011 and 2010, respectively.

(Amounts in thousands except per share data)

NOTE 11 - PENSION PLAN (Continued)

Components of Net Periodic Benefit Cost

	2011	2010
Net periodic pension cost:		
Service cost	$ 399	$ 342
Interest cost	238	205
Expected return on plan assets	(302)	(240)
Amortization of net loss	56	52
Net periodic benefit cost	$ 391	$ 359

The estimated net loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $123,000.

Assumptions

The weighted-average assumptions used to determine benefit obligations at December 31:

	2011	2010
Discount rate	4.37 %	5.52 %
Rate of compensation increase	4.25	4.25

The weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31:

	2011	2010
Discount rate	5.52 %	5.75 %
Expected long-term return on plan assets	8.00	8.00
Rate of compensation increase	4.25	4.25

The long-term rate of return on plan assets gives consideration to returns currently being earned on plan assets, as well as future rates expected to be returned.

(Amounts in thousands except per share data)

NOTE 11 - PENSION PLAN (Continued)

Plan Assets

The Bank's defined benefit pension plan weighted-average asset allocations at December 31 by asset category are as follows:

	2011		2010	
Asset Category				
Mutual funds	62.81	%	58.41	%
Corporate bonds	18.11		19.37	
U.S. government agency securities	18.30		21.52	
Cash and cash equivalents	0.78		0.70	
Total	100.00	%	100.00	%

The Bank believes that the plan's risk and liquidity position are, in large part, a function of the asset class mix. The Bank desires to utilize a portfolio mix that results in a balanced investment strategy. The investment objective for the defined benefit pension plan is to maximize total return with tolerance for average to slightly above average risk. Asset allocation strongly favors mutual funds.

The following table sets forth by level, within the fair value hierarchy, the plan's assets at fair value as of December 31, 2011 and 2010:

	December 31, 2011			
	Level I	Level II	Level III	Total
Assets:				
Cash and cash equivalents	$ 33	$ -	$ -	$ 33
U.S. government agency securities	-	778	-	778
Corporate bonds	-	770	-	770
Mutual funds	2,670	-	-	2,670
Total assets at fair value	$ 2,703	$ 1,548	$ -	$ 4,251

	December 31, 2010			
	Level I	Level II	Level III	Total
Assets:				
Cash and cash equivalents	$ 27	$ -	$ -	$ 27
U.S. government agency securities	-	818	-	818
Corporate bonds	-	736	-	736
Mutual funds	2,220	-	-	2,220
Total assets at fair value	$ 2,247	$ 1,554	$ -	$ 3,801

Cash Flows

The Bank expects to contribute $500,000 to its defined benefit pension plan in 2012.

(Amounts in thousands except per share data)

NOTE 11 - PENSION PLAN (Continued)

Cash Flows (Continued)

The following benefit payments that reflect expected future service, as appropriate, are expected to be paid:

		Pension Benefits
2012	$	89
2013		83
2014		94
2015		140
2016		164
2017 through 2021		1,774
	$	2,344

NOTE 12 - REGULATORY MATTERS

Cash and Due from Banks

The district Federal Reserve Bank requires the Bank to maintain certain average reserve balances. As of December 31, 2011, the Bank had required reserve of $150,000.

Loans

Federal law prevents the Company from borrowing from the Bank unless the loans are secured by specific collateral. Further, such secured loans are limited in amount to 10 percent of the Bank's common stock and capital surplus.

Dividends

The Bank is subject to a dividend restriction that generally limits the amount of dividends that can be paid by a national bank. Prior approval of the Comptroller of the Currency is required if the total of all dividends declared by a national bank in any calendar year exceeds net profits, as defined for the year, combined with its retained net profits for the two preceding calendar years less any required transfers to surplus. Using this formula, the amount available for payment of dividends by the Bank in 2012, without approval of the Comptroller, is approximately $5,662,000 plus 2012 net profits retained up to the date of the dividend declaration.

Capital Requirements

Federal regulations require the Company and the Bank to maintain minimum amounts of capital. Specifically, each is required to maintain certain minimum dollar amounts and ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average total assets.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act ("FDICIA") established five capital categories ranging from "well capitalized" to "critically undercapitalized." Should any institution fail to meet the requirements to be considered "adequately capitalized," it would become subject to a series of increasingly restrictive regulatory actions.

(Amounts in thousands except per share data)

NOTE 12 - REGULATORY MATTERS (Continued)

Capital Requirements (Continued)

As of December 31, 2011 and 2010, the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well capitalized financial institution, Total risk-based, Tier I risk-based, and Tier I leverage capital ratios must be at least 10 percent, 6 percent, and 5 percent, respectively.

The Company's actual capital ratios are presented in the following table that shows the Company met all regulatory capital requirements. The capital position of the Bank does not differ significantly from the Company's.

	2011		2010	
	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-Weighted Assets)				
Actual	$ 40,319	20.08 %	$ 36,802	18.54 %
For capital adequacy purposes	16,062	8.00	15,876	8.00
To be well capitalized	20,077	10.00	19,845	10.00
Tier I Capital (to Risk-Weighted Assets)				
Actual	$ 37,809	18.83 %	$ 34,321	17.29 %
For capital adequacy purposes	8,031	4.00	7,938	4.00
To be well capitalized	12,046	6.00	11,907	6.00
Tier I Capital (to Average Assets)				
Actual	$ 37,809	8.37 %	$ 34,321	8.20 %
For capital adequacy purposes	18,073	4.00	16,742	4.00
To be well capitalized	22,591	5.00	20,928	5.00

NOTE 13 - FAIR VALUE MEASUREMENTS

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels of pricing observations are as follows:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.

Level III: Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the use of observable market data when available.

(Amounts in thousands except per share data)

NOTE 13 - FAIR VALUE MEASUREMENTS (Continued)

The following table presents the assets reported on the balance sheet at their fair value as of December 31, 2011 and 2010, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	December 31, 2011			
	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Investment securities available for sale:				
U.S. government agency securities	$ -	$ 1,000	$ -	$ 1,000
Obligations of states and political subdivisions	-	52,550	-	52,550
Mortgage-backed securities in government-sponsored entities	-	115,918	-	115,918
Corporate debt securities	-	467	-	467
Equity securities in financial institutions	130	-	-	130
Total	$ 130	$ 169,935	$ -	$ 170,065

	December 31, 2010			
	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Investment securities available for sale:				
U.S. government agency securities	$ -	$ 1,000	$ -	$ 1,000
Obligations of states and political subdivisions	-	41,661	-	41,661
Mortgage-backed securities in government-sponsored entities	-	95,655	-	95,655
Equity securities in financial institutions	114	-	-	114
Total	$ 114	$ 138,316	$ -	$ 138,430

(Amounts in thousands except per share data)

NOTE 13 - FAIR VALUE MEASUREMENTS (Continued)

The following table presents the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value as of December 31, 2011 and 2010, by level within the fair value hierarchy. Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loan include: quoted market prices for identical assets classified as Level I inputs; observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs. The fair values consist of the loan balances of $156,000 and $608,000 less their valuation allowances of $20,000 and $350,000 at December 31, 2011 and 2010, respectively.

Other real estate owned ("OREO") is measured at fair value, less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less cost to sell.

	December 31, 2011			
	Level I	Level II	Level III	Total
Fair value measurements on nonrecurring basis:				
Impaired loans	$ -	$ -	$ 136	$ 136
Other real estate owned	-	-	102	102
Total	$ -	$ -	$ 238	$ 238

	December 31, 2010			
	Level I	Level II	Level III	Total
Fair value measurements on nonrecurring basis:				
Impaired loans	$ -	$ -	$ 258	$ 258
Other real estate owned	-	-	232	232
Total	$ -	$ -	$ 490	$ 490

(Amounts in thousands except per share data)

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair values at December 31 of the Company's financial instruments are as follows:

	2011		2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and cash equivalents	$ 12,713	$ 12,713	$ 9,911	$ 9,911
Investment securities:				
Available for sale	170,065	170,065	138,430	138,430
Held to maturity	4,099	4,149	3,868	3,929
Loans held for sale	1,166	1,166	7,610	7,610
Net loans	248,499	254,077	243,929	247,921
Regulatory stock	2,025	2,025	1,834	1,834
Mortgage servicing rights	604	604	320	320
Accrued interest receivable	1,605	1,605	1,365	1,365
Financial liabilities:				
Deposits	$ 405,103	$ 409,649	$ 375,199	$ 377,817
Short-term borrowings	-	-	422	422
Other borrowings	5,072	5,177	5,072	5,345
Accrued interest payable	246	246	269	269

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract that creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas. As many of these assumptions result from judgments made by management based upon estimates that are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets, such as deferred tax assets and premises and equipment, are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash and Cash Equivalents, Loans Held for Sale, Regulatory Stock, Accrued Interest Receivable, Short-Term Borrowings, and Accrued Interest Payable

The fair value is equal to the current carrying value.

Investment Securities

The fair market value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Fair values for certain corporate bonds were determined utilizing discounted cash flow models, due to the absence of a current market to provide reliable market quotes for the instruments.

Loans

Fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were utilized as estimates for fair value.

Mortgage Servicing Rights

The fair value for mortgage servicing rights is estimated by discounting contractual cash flows and adjusting for prepayment estimates. Discount rates are based upon rates generally charged for such loans with similar characteristics.

Deposits and Other Borrowings

The fair values of certificates of deposit and other borrowed funds are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities. Demand, savings, and money market deposit accounts are valued at the amount payable on demand as of year-end.

Commitments to Extend Credit and Commercial Letters of Credit

These financial instruments are generally not subject to sale, and estimated fair values are not readily available.

The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments and letters of credit are presented in Note 10.

NOTE 15 - SUBSEQUENT EVENTS

Management has reviewed events occurring through March 19, 2012, the date the financial statements were issued and no subsequent events occurred requiring accrual or disclosure.

(Amounts in thousands except per share data)

NOTE 16 - PARENT COMPANY

CONDENSED BALANCE SHEET

	December 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 88	$ 75
Investment securities available for sale	114	99
Investment in subsidiary bank	37,956	34,710
Other assets	1	6
TOTAL ASSETS	$ 38,159	$ 34,890
Other liabilities	$ 6	$ 8
TOTAL LIABILITIES	6	8
TOTAL STOCKHOLDERS' EQUITY	38,153	34,882
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 38,159	$ 34,890

CONDENSED STATEMENT OF INCOME

	Year Ended December 31, 2011	Year Ended December 31, 2010
INCOME		
Dividends from subsidiary	$ 715	$ 1,020
Investment security loss	-	(3)
Other income	5	4
	720	1,021
EXPENSE		
Other noninterest expense	4	4
Net income before income taxes, equity in undistributed earnings of subsidiary	716	1,017
Income tax expense	2	-
Income before equity in undistributed earnings of subsidiary	714	1,017
Equity in undistributed earnings of subsidiary	3,498	2,164
NET INCOME	$ 4,212	$ 3,181

(Amounts in thousands except per share data)

NOTE 16 - PARENT COMPANY (Continued)

CONDENSED STATEMENT OF CASH FLOWS

	Year Ended December 31, 2011	2010
OPERATING ACTIVITIES		
Net income	$ 4,212	$ 3,181
Adjustment to reconcile income to net cash provided by operating activities:		
Equity in undistributed earnings of subsidiary	(3,498)	(2,164)
Investment security loss	-	3
Net cash provided by operating activities	714	1,020
INVESTING ACTIVITY		
Purchases of investment securities available for sale	(7)	-
Net cash used for investing activities	(7)	-
FINANCING ACTIVITIES		
Cash dividends paid	(694)	(617)
Purchases of treasury stock	-	(345)
Net cash used for financing activities	(694)	(962)
Net increase in cash	13	58
CASH AT BEGINNING OF YEAR	75	17
CASH AT END OF YEAR	$ 88	$ 75