VODAFONE GROUP PUBLIC LTD CO
Form 6-K
June 14, 2004

Form 6-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Report of Foreign Private Issuer

Pursuant to Rules 13a-16 or 15d-16 of the Securities Exchange Act of 1934

Dated June 14, 2004

VODAFONE GROUP PUBLIC LIMITED COMPANY

(Exact name of registrant as specified in its charter)

VODAFONE HOUSE, THE CONNECTION, NEWBURY, BERKSHIRE, RG14 2FN, ENGLAND
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F   Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes   No

If “Yes” is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82

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Group Financial Highlights

Statutory

	Year ended 31 March 2004 £m	Year ended 31 March 2003 £m	Change %
Group turnover	33,559	30,375	10
Total Group operating profit, before goodwill amortisation and exceptional items	10,749	9,181	17
Profit on ordinary activities before taxation, goodwill amortisation and exceptional items	10,035	8,429	19
Goodwill amortisation	(15,207)	(14,056)	8
Exceptional operating items	228	(576)	
Exceptional non-operating items	(103)	(5)	
Loss on ordinary activities before taxation	(5,047)	(6,208)	(19)
Loss for the financial year	(9,015)	(9,819)	(8)

Proportionate

	Turnover			EBITDA before exceptional items		
	Year ended 31 March 2004 £m	Year ended 31 March 2003 £m	Change %	Year ended 31 March 2004 £m	Year ended 31 March 2003 £m	Change %
Mobile telecommunications	37,969	31,853	19	14,826	12,235	21
Other operations	1,477	2,073	(29)	288	444	(35)
	39,446	33,926	16	15,114	12,679	19

Proportionate information is calculated as described on page 37.

Cash flow information

	Year ended 31 March 2004 £m	Year ended 31 March 2003 £m	Change %
Net cash inflow from operating activities	12,317	11,142	11
Free cash flow	8,521	5,171	65
Net debt at 31 March	(8,488)	(13,839)	(39)

Per share information

	Year ended 31 March 2004	Year ended 31 March 2003	Change %
Earnings/(loss) per share			
before goodwill amortisation and exceptional items	9.10p	6.81p	34
after goodwill amortisation and exceptional items	(13.24)p	(14.41)p	(8)
Dividends per share	2.0315p	1.6929p	20

The Summary Financial Statement contains certain information on the Group s results and cash flows that have been derived from amounts calculated in accordance with UK Generally Accepted Accounting Principles, (UK GAAP), but are not themselves UK GAAP measures. They should not be viewed in isolation as alternatives to the equivalent GAAP measure and should be read in conjunction with the equivalent UK GAAP measure. Further disclosures are also provided under Use of Non-GAAP Financial Information on page 42.

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Report from your Chairman

It is my privilege to report, once again, another highly successful year for your company, with an excellent overall operating performance generating further substantial growth in profits and cash flows.

Lord MacLaurin of Knebworth, DL
Chairman

Your company s total venture mobile customer base has increased to over 340 million people. This is a wonderful achievement for a company that is only 20 years old and provides us with a really strong platform as we transition into the next phase of our development. It is only with the dedication and commitment of all members of staff throughout the world that we have achieved such excellent results to date and on behalf of the Board I thank them all.

For us, the year saw a rapid uptake of Vodafone live! across our footprint, following its successful launch last year, with nearly 7 million controlled customers now enjoying the richer mobile telecommunications the service delivers. We also started to introduce 3G to our customers. In February, we launched the Vodafone Mobile Connect 3G/GPRS datacard, which provides fast, secure access to corporate networks from lap top computers, across seven European countries and more recently we announced the launch of consumer services through Vodafone live! with 3G in Germany, Portugal, Italy and Spain. I believe that this technological evolution offers us significant growth opportunities and Vodafone is very well positioned to take advantage of these opportunities due to its global footprint and its continued strong financial performance. Although the mobile telecommunications industry remains extremely competitive, with new entrants driving new technologies and many existing operators having recovered from the financial pressures they faced only a short time ago, your company remains the industry leader.

As our international business expands it is essential that, in order to deliver the best possible experience to our customers and to achieve brand preference, we provide similar levels of excellence in all of our markets. To this end we have created two new central functions, Group Marketing and Group Technology & Business Integration. Group Marketing, led by Peter Bamford, provides leadership and coordination across a range of marketing and commercial activities including brand, product development, content management, Partner Networks and global accounts. Group Technology & Business Integration, headed by Thomas Geitner, leads the implementation of a standardised architecture for business process, information technology and network systems, which will support the next generation of products and services and the critical role of introducing and operating 3G capacity.

During the year, we continued our policy of increasing our shareholdings in existing operations, moving to 100% in Vodafone Malta and over 99% in Vodafone Greece. In the UK, we acquired prominent service providers, Singlepoint (4U) Limited and Project Telecom Plc, increasing our direct access to our UK contract customer base to over 90%. We also disposed of interests in mobile businesses in India and Mexico, as well as our fixed line operations in Japan. In addition, we extended our Partner Networks to a total of 13 countries through new agreements with operators in Bahrain, Cyprus, Iceland, Lithuania, Luxembourg and Singapore.

We expect to add further countries in the coming year.

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Report from your Chairman continued

In February of this year, we entered into a high profile auction process for the acquisition of AT&T Wireless in the US. One of the many responsibilities that your Board has is its duty to shareholders to explore opportunities where it believes enhanced shareholder value may be achieved. Your Board considered that acquiring AT&T Wireless at the right price would have enhanced the Group s position in the US and delivered, over time, better returns for shareholders.

In entering the auction process your Board determined a price ceiling which, had it been exceeded, would not have provided the returns we considered necessary to justify such an acquisition. In the event, our ceiling price was exceeded by Cingular Wireless and we retain our 45% investment in the leading mobile operator in the US, Verizon Wireless. Our relationship with Verizon Communications, our partner in Verizon Wireless, remains strong. They supported our participation in the auction and we look forward to continuing to work with them to further strengthen Verizon Wireless.

Corporate governance continues to be at the forefront of your Board s considerations. During the year we have fully complied with the Combined Code relating to corporate governance, as set out in the Listing Rules of the London Stock Exchange. In addition, we also have to comply with US securities laws. The Sarbanes-Oxley Act of 2002 has introduced a number of changes to corporate governance requirements with which we have complied this year and with which we will comply as new requirements are introduced over the coming years. More details of the corporate governance work of your Board are provided later in this Annual Review & Summary Financial Statement.

On 1 September 2003, Luc Vandevelde joined the Board as a non-executive director. He brings with him many years of experience gained in retailing and consumer goods and his financial, management and marketing skills in international business will be of great value to the Board. I would also like to congratulate my colleague Alec Broers who was advised on 1 May 2004 that Her Majesty the Queen intends to make him a Life Peer for his contribution to engineering and higher education.

Vodafone is a vibrant company, dedicated to the creation of shareholder value. This value is achieved through the enhancement of products and services such as Vodafone live! , the advance in technology 3G and the investment in assets where positive returns may be clearly identified. A progressive dividend policy and our share buy back programme are means by which value is returned to shareholders. In light of the excellent results and the confidence with which it views the future, the Board is recommending the payment of a final dividend per share of 1.0780 pence which, together with the interim dividend already paid, makes a total dividend for the year of 2.0315 pence, an increase of 20%. We will also seek your approval to extend the share buy back programme we announced in November, with £3 billion of purchases planned for next year, following the £1.1 billion purchased up to March 2004.

As a global business, we are mindful of our responsibilities to all stakeholders around the world and in particular that the delivery of our services should have as little impact on the environment as possible. As part of this endeavour, I would encourage shareholders to receive communications from us electronically. In doing so, documents are provided more quickly, communications are less costly and importantly it is more environmentally friendly.

As we transition to a new era in mobile telecommunications, I am confident that, through our focus on our strategic goals, we are well positioned to make further significant progress in the year ahead.

Lord MacLaurin of Knebworth, DL
Chairman

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Left to right:	**Phil Williams**, Group Human Resources Director; **Arun Sarin**, Chief Executive;
	Melissa Stimpson, Group Investor Relations Director and **Stephen Scott**, Group General Counsel and Company Secretary

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Report from your Chief Executive

Mobile telecommunications is one of the most dynamic industries today. Its potential is vast.

Today wireless technology only reaches one fifth of the world's population. In fact, 2 billion people have never even made a phone call. I'm delighted by the prospect that their first call could very well be made on a mobile phone.

In the coming years, the increasing number of mobile customers will enjoy a very different range of services. With the arrival of 3G and other new technologies and the significant increase in voice capacity and data rates they provide, the opportunity for growth in this industry is tremendous. The wireless future holds even more ways for people to share memorable moments, anywhere, anytime.

During my first year with Vodafone I have visited every part of our organisation, met with customers, employees, business leaders, regulators and stakeholders. I have reviewed our strategies, studied our operational practices and taken stock of the business we are managing on behalf of our customers and our shareholders. I am inspired by what I see.

Across our business we have plans to capitalise on market trends by applying our understanding of customer needs and deploying systems and technology to deliver high quality, great value, wireless services.

Our position

This past year, Vodafone has delivered another set of solid financial results. We have had excellent customer growth, good revenue growth, continued margin improvement and generated outstanding free cash flow. As a result of this performance we propose to increase the dividend by 20% and expand the share purchase programme we introduced at the end of last year.

Today we operate across 26 markets, including 16 controlled operations. In addition, through our Partner Network programme, we have a further presence in 13 markets where we have a strong brand and service position without financial investment. More than 50,000 Vodafone employees now serve 133 million proportionate customers.

The third area where we see revenue growth potential is Infotainment the combination of information and entertainment. We have already seen eagerness for these services through Vodafone live! . Our customers can take and send pictures, browse branded infotainment, listen to audio files, watch video clips, play games and customise ringtones with their favourite songs, all from an integrated camera phone and an easy to use icon-driven menu.

Whilst we have made a strong start, the real opportunity to unearth more revenue comes with 3G, when capacity and speeds are far better than those we have today.

We can't predict all of the applications that customers will want in the coming years but we can anticipate their needs, build the infrastructure and platforms and collaborate with companies that understand how to grant the freedom to play games, watch television, conduct business and communicate anywhere and anytime.

Best of all, most of these activities are things people are already doing through different media today. Our success doesn't require a big behavioural change. We are simply mobilising those things that people are already accustomed to doing.

Forces on the business

As we move forward, we must successfully navigate four forces impacting on our business customers, technology, competitors and regulation addressing the inherent opportunities and challenges they bring.

Our customers today expect more from us. They want to pay less yet get greater value for their Pound, Dollar, Euro or Yen. They expect greater coverage and reliability.

Advances in technology hold the key to delighting our customers and we are fully committed to making 3G deliver on its promises. We are investing significantly every year in 3G and we are investing time and energy to encourage co-operation between vendors so that the mobile environment can operate to global standards that way our

I believe that our company is in an unprecedented position to take full advantage of opportunities in the wireless world. All of us at Vodafone are working hard to grow revenue, navigate the forces that impact our business and lay claim to the benefits of our global scale and scope.

Opportunities for growth

At Vodafone we predict significant growth will come from: Telecommunications, Information Technology and Infotainment.

Voice remains at the heart of our business and there continues to be significant demand. Today, only about 20% of voice usage is mobile, so we can expect some portion of the remaining 80% to migrate to our networks. It is interesting to note that the growth of mobile has not significantly eroded the value of the fixed line industry. In effect, mobile has served to increase the value of the entire telecoms industry.

The second growth area is in Information Technology (IT) or what we think of as the productivity market. We plan to grow revenues by mobilising office tools and software applications. We have already begun by establishing a number of strategic partnerships with other industry players aimed at unleashing powerful 'made for mobile' applications over our 3G networks.

customers get the best from our services wherever they go.

Another significant force impacting our business is competition. We face different competitors across our markets, but we have a tremendous advantage. Vodafone can draw from resources across all our markets and respond competitively in a way that does not impact the performance of the organisation as a whole.

Regulation is also part of our everyday life. Regulators understand that Vodafone is an important company in their respective countries. They are keenly aware of the economic and social impact we have on their citizens and communities. We hope that future decisions will continue to be made in the best interests of our customers and the health of this vital global industry.

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Report from your Chief Executive continued

Our goals

At Vodafone, everything we do furthers our desire to create mobile connections for individuals, businesses and communities. Our Vision is to be the world's mobile communications leader and we're delighted by the prospects for the future of our industry.

Our commitment to this industry is underlined by our company values, which state that everything we do is driven by our passion for customers, our people, results and the world around us.

The success of our effort requires a commitment to deliver on our six strategic goals:

Provide superior shareholder returns

The continued strength in our financial performance enables us to increase returns to our shareholders on an ongoing basis. During the past year we have done this through increasing our dividends and our share purchase programme. In the next 12 months, we intend to expand this share purchase programme further, buying back shares worth £3 billion and returning, through our dividends and our share purchases, more than 50% of the cash we have generated.

By delivering on our goals and conducting rigorous economic and financial analyses before we make pricing, acquisition and scale decisions, we demonstrate the discipline to always act in the best interests of our shareholders.

Delight our customers

We have rededicated ourselves to delighting our customers because we believe this is the foundation for our continued success.

We recognise that every customer interaction provides another opportunity to win loyalty and that's why we continue to raise standards on the quality of customer care in our call centres and our stores and the quality of our networks.

Key to delighting our customers is our ability to deliver superior voice and data services according to differing customer needs. Vodafone live! with 3G has been introduced in four countries in Europe and several more countries will follow in the next few months. For our business customers, the launch of Vodafone Mobile Connect 3G/GPRS datacard in February has been very successful.

Throughout the past few years, Vodafone has done a terrific job of building brand awareness as we have moved towards a single global brand. Beyond brand awareness, we want people to understand that the Vodafone name represents great service, great value and great innovation. When our name becomes synonymous with these attributes we will achieve brand preference and expect to see our market share climb as a result.

Leverage global scale and scope

Another unique advantage for Vodafone is our expansive global footprint. Operating in 26 markets puts us in an enviable position to leverage our global scale and scope. We are using this advantage to deliver exceptional 3G-based services. When we introduce 3G handsets in large volumes later this year we will be well equipped to drive demand and attract even higher market share in the 3G world.

Another competitive advantage is our leadership position on cost and time to market. From network services to sales, and marketing to customer care and billing, we have many varied systems in use across the business. With strong co-operation between our various operating companies we can achieve further savings.

Expand market boundaries

Expanding our market boundaries is another priority for Vodafone. We continue to build productive strategic relationships in the mobile environment. In the productivity areas we are working with Microsoft and other IT companies. In the content areas, we have recently taken a big step forward in the music arena through our agreement with Sony Music.

In our changing industry, opportunities to expand geographically will continue to present themselves and, if they make sense both strategically and financially, we will give them serious consideration.

We have just reinforced our long-term commitment to Japan by making a further investment of up to £2.6 billion. Our transactions in Japan will simplify the structure, confirm our commitment to the Japanese marketplace and enable us to deliver on the changes needed to improve our position.

Build the best global Vodafone team

As the business expands and the environment around us evolves, it is crucial for us to develop, recruit and retain the people that will lead us into this new world. We are working hard to make sure our employees have the right skills and knowledge to anticipate our customers' needs. We are identifying new ways to share the best of what we do on a global basis. We continue to reap the benefits of a motivated team with a strong customer service culture, which will help earn a reputation for Vodafone that is second to none.

Be a responsible business

As a large, multinational company we inevitably raise expectations amongst all our stakeholders and hold ourselves up to public scrutiny. Being a responsible business is about the way we manage our impact on society, the environment and the economy. We are committed to the highest standards of business integrity and corporate governance.

Our businesses around the world are important to the infrastructure of the economies and societies we serve and we take our broader corporate responsibilities seriously. Through our actions we will continue to strive to earn the trust and confidence of all our stakeholders worldwide.

Six goals, one aim

These six goals are well within our reach. Now it comes down to execution. Country by country, we have assembled a team of the most capable leaders in the wireless industry. They are supported by outstanding people who come to work every day eager and prepared to delight our customers, win market share and produce great results.

We are in an enviable industry position to succeed by virtue of our scale and scope and our operating philosophy. We are passionate and excited about our future and we look forward to sharing our success with you in the years ahead.

Arun Sarin
Chief Executive

Care centre team in Milan

Investment in staff training and state-of-the-art facilities has led to the creation of customer care centres of excellence to delight our customers.

Delight our customers

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Left to right: **Devin Brougham**, Director Office of Group COO, **Michael Pitt**, Financial Director Group Operations
Julian Horn-Smith, Group Chief Operating Officer

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Operating and Financial Review

Operating results

We are pleased to set out further details of the Group s operating performance in the 2004 financial year and our view of our prospects for the year ending 31 March 2005.

Group overview

	Year ended 31 March	
	2004 £m	2003 £m
Turnover	33,559	30,375
Direct costs [(1)]	(13,378)	(11,825)
Operating expenses [(1)]	(7,541)	(7,333)
Depreciation and amortisation [(1)] [(2)]	(4,549)	(4,141)
Share of profit in joint ventures and associated undertakings [(1)]	2,658	2,105
Total Group operating profit [(1)]	10,749	9,181
Goodwill amortisation	(15,207)	(14,056)
Exceptional operating items	228	(576)
Total Group operating loss	(4,230)	(5,451)
Exceptional non-operating items	(103)	(5)
Net interest expense	(714)	(752)
Taxation	(3,154)	(2,956)
Loss on ordinary activities after taxation	(8,201)	(9,164)
Loss for the financial year	(9,015)	(9,819)

(1) before goodwill amortisation and exceptional items
(2) includes loss on disposal of tangible final assets

Turnover

Turnover increased 10% in the 2004 financial year, as analysed below:

	Mobile %	Non-mobile %	Group %
Impact of			
Organic growth	10	5	10
Foreign exchange	4	9	4
Acquisitions & disposals	1	(49)	(4)

Reported growth	15	(35)	10

The impact of acquisitions and disposals resulted mainly from the disposal of Japan Telecom. The foreign exchange impact primarily arose due to a stronger Euro.

Mobile telecommunications

	Year ended 31 March		
	2004 £m	2003 £m	Change %
Service revenues:			
Voice	23,618	21,201	11
Data	4,540	3,622	25
Subtotal	28,158	24,823	13
Equipment & other	3,557	2,719	31
Total mobile revenues	31,715	27,542	15

The principal component of the increase in turnover from mobile telecommunications arose from service revenue growth of 13%, driven primarily by growth in our controlled customer base, which increased by 9% over the prior year.

ARPU was up in Italy and the UK and down in Japan and Germany, compared with the year ended 31 March 2003.

Total outgoing voice usage in controlled mobile businesses increased by 11% over the year to 154.8 billion minutes for the year ended 31 March 2004, although the effect on ARPU was partially offset by tariff reductions and regulatory intervention. Lower termination rates, resulting from regulatory changes, have reduced service revenue by an estimated £0.3 billion in the year.

Another key driver of the growth in service revenue was the continued success of the Group s data product and service offerings. Revenues from data services increased 25% to £4,540 million for the year ended 31 March 2004 and represented 16.1% of service revenues in our controlled mobile subsidiaries for the twelve months ended 31 March 2004, compared with 14.6% for the 2003 financial year. SMS revenues continue to represent the largest component of both the level of and growth in data revenues. Non-messaging data revenues increased to 4.2% of service revenues from 3.6% in the prior financial year as a result of the increased focus on providing value-added services, particularly through Vodafone live! , our business offerings and the increased penetration of data services into our customer base.

Mobile equipment and other turnover increased 31% to £3,557 million, due to revenues from non-Vodafone customers acquired as a result of the acquisition of service providers in the UK and increased acquisition and retention activity. Excluding these revenues, mobile equipment and other turnover increased slightly as a result of higher gross connections and upgrades.

Non-mobile businesses

Turnover from other operations decreased by 35% to £1,844 million in the year, principally as a result of the deconsolidation of Japan Telecom from 1 October 2003 and the disposal of the Telematiks business by Arcor in the previous year.

Operating loss

After goodwill amortisation and exceptional items, we reported a total operating loss of £4,230 million, compared with a loss of £5,451 million for the previous year.

The £1,221 million reduction in the total operating loss arose as a result of a £228 million credit in respect of exceptional operating items in the year ended 31 March 2004, compared with an expense of £576 million in the prior year and a £1,568 million increase in operating profit before goodwill amortisation and exceptional items, partially offset by a £1,151 million increase in the goodwill amortisation charge.

The charges for goodwill amortisation, which do not affect our cash flows or our ability to pay dividends, increased by 8% to £15,207 million, principally as a result of the impact of foreign exchange movements.

Expenses

	Year ended 31 March 2004 % of turnover	2003 % of turnover
Direct costs	39.9	38.9
Operating expenses	22.5	24.1
Depreciation & amortisation	13.6	13.6

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Operating and Financial Review continued

The increase in direct costs as a percentage of turnover is principally due to an increase in the proportion of acquisition and retention costs, primarily following the acquisition of a number of service providers in the UK. Acquisition and retention costs net of equipment revenues as a percentage of service revenues, for our controlled mobile businesses, increased to 12.6%, compared with 12.3% for the comparable period. This was partially offset by the disposal of Japan Telecom. The principal reason for the improvement in operating expenses as a percentage of turnover was the maintenance of network operating costs at a similar level to the previous financial year, despite the growth in customer numbers and usage. Operating expenses as a proportion of turnover also benefited from the disposal of Japan Telecom.

Depreciation and amortisation charges, excluding goodwill amortisation, increased by 10% to £4,549 million from £4,141 million in the comparable period. The launch of 3G services in a number of countries resulted in approximately £0.3 billion of additional depreciation and amortisation in the current year as 3G infrastructure and licences have been brought into use.

Exceptional operating items

Exceptional operating income for the year ended 31 March 2004 of £228 million comprises £351 million of recoveries and provision releases in relation to a contribution tax levy on Vodafone Italy that is no longer expected to be levied, net of £123 million of restructuring costs, principally in Vodafone UK.

Exceptional operating items of £576 million were charged in the year ended 31 March 2003, comprising £485 million of impairment charges in relation to our interests in Japan Telecom and Grupo Iusacell, and £91 million of reorganisation costs relating to the integration of Vizzavi into the Group and related restructuring.

Loss on ordinary activities before interest

Our loss on ordinary activities before interest fell by 21% to £4,333 million due to a reduction in the total operating loss of £1,221 million offset by an increase in the charge for exceptional non-operating items of £98 million.

Exceptional non-operating items

Net exceptional non-operating charges for the year of £103 million principally relate to a loss on disposal of the Japan Telecom fixed line operations. In the prior year, net exceptional non-operating charges of £5 million mostly represented a profit on disposal of fixed asset investments of £255 million, mostly relating to the disposal of the Group s interest in Bergemann GmbH, through which the Group s 8.2% stake in Ruhrgas AG was held, offset by an impairment charge in respect of our investment in China Mobile of £300 million.

Net interest payable

Net interest payable, including our share of the net interest expense of joint ventures and associated undertakings, decreased from £752 million for the year ended 31 March 2003 to £714 million for the year ended 31 March 2004.

Our net interest cost for the current year increased to £499 million, including £215 million (2003: £55 million) relating to potential interest charges arising on settlement of a number of outstanding tax issues, from £457 million for the prior year, and was covered 28 times by operating cash flow plus dividends received from associated undertakings.

Our share of the net interest expense of associated undertakings and joint ventures decreased from £295 million to £215 million, principally as a result of the sale of our stake in Grupo Iusacell.

Taxation

The effective rate of taxation, before goodwill amortisation and exceptional items, for the year ended 31 March 2004 was 30.4% compared with the 35.5% for the year ended 31 March 2003. The rate has fallen principally due to further benefits arising out of the restructuring of the Group s Italian operations in the prior year, from the current year restructuring of the French operations, a fall in the Group s weighted average tax rate and benefits from other tax incentives. These benefits have outweighed the absence of the one-off benefit arising from the restructuring of the German group in the previous year.

Basic loss per share

Basic loss per share, after goodwill amortisation and exceptional items, improved from a loss per share of 14.41p to a loss per share of 13.24p for the year ended 31 March 2004. The loss per share includes a charge of 22.33p per share (2003: 20.62p per share) in relation to the amortisation of goodwill and a charge of 0.01p per share (2003: 0.60p per share) in relation to exceptional items.

Balance sheet

Assets

Intangible fixed assets decreased from £108,085 million at 31 March 2003 to £93,622 million at 31 March 2004, as a result of £13,095 million of goodwill and £97 million of other amortisation charges to the profit and loss account in the 2004 financial year and £2,683 million of exchange movements, partially offset by £1,434 million of goodwill arising on acquisitions made in the 2004 financial year.

Tangible fixed assets decreased from £19,574 million at 31 March 2003 to £18,083 million at 31 March 2004 as a result of £4,362 million depreciation charges in the 2004 financial year and assets disposed with Japan Telecom, offset by £4,751 million of additions during the year.

Our investments in associated undertakings reduced from £25,825 million at 31 March 2003 to £21,226 million at 31 March 2004, mainly as result of £2,830 million of exchange movements and £2,112 million of goodwill amortisation charges in the 2004 financial year.

Other fixed asset investments at 31 March 2004 totalled £1,049 million (2003: £1,164 million) and include our equity interest in China Mobile.

Current assets increased to £13,149 million from £8,591 million principally as a result of the increase in cash and liquid investments following our cash flows in the 2004 financial year.

Liabilities

Our total liabilities increased by only 1.4% over the 2004 financial year.

Equity shareholders funds

Total equity shareholders funds decreased from £128,630 million at 31 March 2003 to £111,924 million at 31 March 2004. The decrease comprises the loss for the year of £9,015 million (which includes goodwill amortisation of £15,207 million and exceptional items, net of tax and minority interests, of £6 million), equity dividends of £1,378 million, net currency translation losses of £5,292 million, purchase of treasury shares of £1,088 million and £19 million of other movements, offset by the issue of new share capital of £86 million.

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Leverage global scale and scope

Central terminals team in Dusseldorf

Acting globally, thinking locally, has helped Vodafone provide seamless customer service and develop strong supplier relationships. With Vodafone live! , Vodafone's central terminal specialists worked with manufacturers to integrate the unique Vodafone interface for the most successful global product launch in our history.

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mobile one team in Singapore

Through our Partner Network strategy we are expanding our footprint, strengthening the brand, creating new sources of revenue and improving synergies across the Group. Earlier this year we signed our first Partner in Asia mobile one in Singapore.

Expand market boundaries

Operating and Financial Review continued

Equity dividends

The table below sets out the amounts of interim, final and total cash dividends paid or, in the case of the final dividend for the 2004 financial year, proposed in respect of each financial year.

	Pence per ordinary share	
	Year ended 31 March 2004 Pence	Year ended 31 March 2003 Pence
Interim	0.9535	0.7946
Final	1.0780(1)	0.8983
Total	2.0315	1.6929

(1) The final dividend for the year was proposed on 25 May 2004 payable on 6 August 2004 to holders of record as of 4 June 2004.

The Company has historically paid dividends semi-annually, with the regular interim dividend payable in February and the regular final dividend payable in August.

In considering the level of dividend to declare and recommend, the Board takes account of the outlook for earnings growth, operating cash flow generation, capital expenditure requirements, acquisitions and divestments together with the possibilities for debt reductions and share buy backs. Accordingly, the directors are recommending a final dividend of 1.0780 pence per share, bringing the total for the year to 2.0315 pence per share, representing a 20% increase over last year s total dividend. The Board expects progressively to increase the payout ratio in the future.

Liquidity and capital resources

Cash flows

Operating cash flows increased by 11% over the prior year to £12,317 million, primarily due to the growth in operating profit before goodwill amortisation and exceptional items.

During the year ended 31 March 2004, the Group increased its operating free cash flow by 36% to £7,946 million and generated £8,521 million of free cash flow, as analysed below:

	Year ended 2004 £m	Year ended 2003 £m
Net cash inflow from operating activities	12,317	11,142
Purchase of intangible fixed assets	(21)	(99)
Purchase of tangible fixed assets	(4,508)	(5,289)
Disposal of tangible fixed assets	158	109
Net capital expenditure on intangible and tangible fixed assets	(4,371)	(5,279)
Operating free cash flow	7,946	5,863
Dividends from joint ventures		

and associated undertakings	**1,801**	742
Taxation	**(1,182)**	(883)
Interest on group debt	**31**	(475)
Dividends from investments	**25**	15
Dividends paid to minority interests	**(100)**	(91)
Net cash outflow for returns on investments and servicing of finance	**(44)**	(551)
Free cash flow	**8,521**	5,171

Capital expenditure and financial investment

The decrease in net cash outflow for capital expenditure and financial investment from £5,359 million for the year ended 31 March 2003 to £4,267 million for the year ended 31 March 2004 was due primarily to the timing of cash payments for tangible fixed assets.

During the year ended 31 March 2004, £21 million was spent on intangible assets, principally in respect of additional GSM spectrum in Italy. Our expenditure on tangible fixed assets reduced by £781 million to £4,508 million during the 2004 financial year, including approximately £1.5 billion spent on 3G network infrastructure.

We expect capitalised tangible fixed asset additions to be approximately £5 billion in the next financial year. Incremental expenditure on 3G infrastructure in the 2005 financial year is expected to represent approximately 35% of total capital expenditure and will be financed through operating cash flows and existing borrowing facilities.

Dividends from associated undertakings and dividends to minority shareholders

Dividends from our associated undertakings are generally paid at the discretion of the Board of directors or shareholders of the individual operating companies and we have no rights to receive dividends, except where specified within certain of the companies shareholders agreements. Similarly, we do not have existing obligations under shareholders agreements to pay dividends to minority interest partners of our subsidiaries, except as specified below.

Included in the dividends received from joint ventures and associated undertakings was an amount of £671 million received from Verizon Wireless. Until April 2005, Verizon Wireless distributions are determined by the terms of the partnership agreement distribution policy and comprise income distributions and tax distributions. After the current distribution policy expires, tax distributions will continue and a new distribution policy is expected to be set by the Board of Representatives of Verizon Wireless. In making such policy determinations, the Board shall take into account relevant facts and circumstances including, without limitation, the financial performance and capital requirements of Verizon Wireless. Current projections forecast that tax distributions will not be sufficient to cover the US tax liabilities arising from our partnership interest until 2015, and in the absence of additional distributions above the level of tax distributions during this period, this will result in a net cash outflow. Under the terms of the partnership agreement, the Board has no obligation to provide for additional distributions above the level of the tax distributions.

Pursuant to changes in shareholder agreements that were effected in December 2003, from 1 January 2004 SFR commenced making scheduled quarterly dividend payments. During the year ended 31 March 2004, cash dividends totalling £802 million were received in respect of SFR s earnings during the 2002 and 2003 financial years.

Verizon Communications has an indirect 23.1% shareholding in Vodafone Italy and, under the terms of the shareholders agreement, can request dividends to be paid, provided that such dividend would not impair the financial condition or prospects of Vodafone Italy including, without limitation, credit ratings. For the year ended 31 March 2004, Verizon Communications represented that it had no intention of requesting a dividend. Should circumstances change, however, and dividends be paid in later periods this may result in material cash outflows. At 31 March 2004, Vodafone Italy had cash on deposit with Group companies of £3,201 million.

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Operating and Financial Review continued

Acquisitions and disposals

Net cash outflow from acquisitions and disposals of £1,312 million in the 2004 financial year arose primarily in respect of the business acquisitions of additional stakes in certain existing European subsidiary undertakings and the acquisition of three UK independent service providers, partially offset by the disposal of Japan Telecom. An analysis of the main transactions in the year ended 31 March 2004 is shown below.

	£m
Acquisitions:	
Vodafone Portugal	(410)
Vodafone Netherlands	(144)
Vodafone Greece	(815)
Singlepoint	(417)
Other acquisitions	(278)
Net cash acquired with subsidiary undertakings	10
Disposals:	
Japan Telecom	966
Other disposals	34
Net cash disposed of with subsidiary undertakings	(258)
	(1,312)

Share purchase programme

When considering how increased returns to shareholders can be provided in the form of dividends and share purchases, the Board reviews the free cash flow, anticipated cash requirements and gearing of the Group.

On 18 November 2003, we decided to introduce a share purchase programme and allocated £2.5 billion to this programme. Shares have been purchased on market on the London Stock Exchange in accordance with shareholder approval obtained at the Annual General Meeting (AGM) in July 2003 which expires at the conclusion of our AGM on 27 July 2004. The maximum share price payable for any share purchase is no greater than 105% of the average of the middle market closing price of our share price on the London Stock Exchange for the five business days immediately preceding the day on which any shares were contracted to be purchased. Purchases are made only if accretive to earnings per share, before goodwill amortisation and exceptional items. In accordance with the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 issued on 1 December 2003, shares purchased are held in treasury.

For the period from 1 December 2003 to 31 March 2004, 800 million shares for a total consideration of £1.1 billion, including stamp duty and broker commissions, were purchased. The average share price paid, excluding transaction costs, was 135.3 pence compared with the average volume weighted price over the same period of 137.5 pence.

The Board intends to decide the amount to allocate to the share purchase programme on an annual basis at the end of each financial year. In addition to the £1.1 billion already expended, £3 billion of shares are planned to be purchased over the next year, starting in early June 2004, subject to maintenance of credit ratings, superseding the £2.5 billion announced in November 2003.

Because shareholder approval to purchase shares expires on 27 July 2004, this amount is subject to receiving renewed shareholder approval on 27 July 2004 at the AGM. In addition to ordinary market purchases, we currently plan to purchase shares during our close periods.

Funding

As a result of the cash flow items discussed above and £144 million of foreign exchange movements, our consolidated net debt position at 31 March 2004 improved to £8,488 million, from £13,839 million at 31 March 2003. This represented approximately 10% of our market capitalisation at 31 March 2004, compared with 18% at 31 March 2003.

We remain committed to maintaining a solid credit profile, as currently demonstrated by our stable credit ratings of P-1/F1/A-1 short-term and A2/A/A long term from Moody s, Fitch Ratings and Standard & Poor s, respectively. Credit ratings are not a recommendation to purchase, hold or sell securities, in as much as ratings do not comment on market price or suitability for a particular investor and are subject to revision or withdrawal at any time by the assigning rating organisation. Each rating should be evaluated independently.

Our credit ratings enable us to have access to a wide range of debt finance, including commercial paper, bonds and committed bank facilities. We currently have US and euro commercial paper programmes of $15 billion and £5 billion, respectively, which are available to be used to meet short-term liquidity requirements and which were undrawn at 31 March 2004 and 31 March 2003. The commercial paper facilities are supported by $10.4 billion (£5.7 billion) of committed bank facilities, comprised of a $5.5 billion Revolving Credit Facility that matures in June 2004 but which can be extended for one year, and a $4.9 billion Revolving Credit Facility that matures in June 2006.

As at 31 March 2004, no amounts had been drawn under either facility. We also have a ¥225 billion (£1,177 million) fully drawn committed bank facility and other fully drawn bilateral facilities of ¥12.1 billion (£63 million), expiring at various dates until January 2007. Furthermore, Vodafone Egypt, Vodafone Hungary and Vodafone Albania have committed facilities that may only be used to fund their operations totalling £467 million, of which £333 million were drawn.

At 31 March 2004, we had approximately £12.4 billion (pounds sterling equivalent) of capital market debt in issue, with maturity dates from September 2004 to November 2032 and £1.6 billion (pounds sterling equivalent) of term funding, including drawings under the above bank facilities.

We hold our cash and liquid investments in accordance with the counterparty and settlement risk limits of the Board approved treasury policy. The main forms of investments at 31 March 2004 were collateralised deposits, money market funds and euro commercial paper.

Pension scheme funding

As at 31 March 2004, the net deficit in our defined benefit pension schemes, calculated under FRS 17, amounted to £103 million (2003: £257 million), comprising a net liability of £165 million (2003: £406 million) offset by a deferred tax asset of £62 million (2003: £149 million). This amount represents less than 0.2% (2003: less than 0.5%) of both our market capitalisation and net assets at that date.

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Provide superior shareholder returns

3G/GPRS datacard team in Dusseldorf
Through the additional capacity of 3G, we can deliver more services more profitably. We have the ability to drive more mobile minutes, deliver improved high quality content and entertainment and enable greater productivity through mobilizing business applications.

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Operating and Financial Review continued

Subsequent event

On 25 May 2004, we announced potential additional investments in Japan which could result in cash outflows of up to £2.6 billion. The investments are consistent with our overall strategy.

Outlook

Please see Forward-Looking Statements on page 43.

For the year ending 31 March 2005

In the coming year, on an organic basis, we anticipate high single-digit average proportionate mobile customer growth, leading to broadly similar growth in proportionate mobile revenues.

Taking into account the necessary investment and costs associated with opening and operating 3G networks, as well as the effects of declines in interconnect rates, we expect the proportionate mobile EBITDA margin to be broadly stable.

As already stated in November 2003, the ongoing impact of the commercial launch of 3G services is expected to increase depreciation and amortisation by around £0.6 billion in the 2005 financial year.

The effective tax rate is expected to be a little higher than the 30.4% for the 2004 financial year due to lower recurring tax benefits, particularly in Italy and the absence of the one-off benefit from restructuring in France, but is subject to the resolution of open issues, planning opportunities, corporate acquisitions and disposals and changes in tax legislation.

For the 2005 financial year, total capitalised fixed asset additions are expected to be around £5 billion, slightly higher than the £4.8 billion for the 2004 financial year, mainly due to deferred investment from that year.

Free cash flow is expected to be around £7 billion, lower than in the 2004 financial year, due to:

the inclusion in that year of:

- £0.6 billion of one-off receipts from hedging instruments; and
- £0.2 billion of free cash flow from the fixed line business in Japan which has been sold,

together with higher cash expenditure expected in the 2005 financial year on:

- approximately £1 billion of additional capital expenditure, mainly due to the unwinding of capital creditors; and
- tax payments, which are expected to be under £2 billion.

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Corporate Social Responsibility

Vodafone is a values-driven company. One of our four Values is Passion for the World Around Us and this has shaped our approach to corporate social responsibility (CSR). More recently, we have introduced a new strategic goal of being a responsible business and there is regular reporting of progress against this goal to the Executive Committee. Our approach is underpinned by our Business Principles.

CSR Governance is based around two key committees the Group Policy Committee, chaired by the Chief Executive, and the Group Operational Review Committee, chaired by the Chief Operating Officer. In addition, the Group Director of Corporate Responsibility reports to the full Board on an annual basis.

Our approach to managing CSR is to integrate it into our business processes. We are making real progress in this area and examples include:

CSR-related risks to the Group s short and long-term value are included within the Board s procedures on internal control and are increasingly embedded throughout our risk management processes;

Integrating CSR into training programmes for senior executives and adding elements into the global leadership programme where we develop leaders of the future;

Our operating companies report on a series of key performance indicators for CSR on a quarterly and annual basis. These are presented alongside financial and operational performance measures;

CSR is included in the long range planning process, allowing operating companies to set long term objectives in relation to Group and locally identified issues.

We continuously refine our approach through engagement with a range of stakeholders. This process helps to identify new risk issues and to develop appropriate responses. For example, during the year we carried out a significant survey of people s views of our CSR performance and their ranking of relevant CSR issues, across our five largest markets. The survey, conducted by MORI, included over 5,000 interviews with the general public, Vodafone customers and non-governmental organisations. We also surveyed public opinion through 17,000 interviews across all our markets on perceptions of mobile phones and masts, and health issues.

This survey-based approach is coupled with face-to-face meetings with nongovernmental organisations, investors and others, either to discuss general CSR performance or to investigate specific issues such as supply chain management.

Our engagement has indicated that we face a number of priority issues: perceptions of mobile and health, consumer issues such as appropriate access to content for younger users, supply chain management, providing products and services to those with difficulty in accessing telecommunications, and management of environmental impacts, with particular emphasis on reusing and recycling of mobile phones.
We have initiatives in place to address these issues. Some highlights this year include:

Launching our Code of Ethical Purchasing and communicating it to our global suppliers. We carried out a pilot CSR assessment of a Panasonic mobile phone factory in Manila;

Developing responsible marketing guidelines for our operating companies and introducing content standards for Vodafone live! ;

Engaging the global product development community in the identification and promotion of mobile products and services that have high social value. For example, working with our partners in Kenya and Tanzania and with funding support from the UK Government, we are exploring how mobile technology can be used to enable the provision of micro finance services;

- Increasing the number of operating companies with mobile phone takeback schemes to 13 and collecting approximately 1.5 million phones;

- Introducing energy efficiency action plans in operations covering over 90% of our customer base, and meeting our target to reuse or recycle 85% of our network equipment waste one year ahead of plan.

In addition, we have created 7 new local charitable foundations, bringing the total to 19, and have invested a total of £22.7 million with The Vodafone Group Foundation, the local foundations or directly in global projects. For more information visit www.vodafonefoundation.org

However, there remain challenges in creating change across a global business. For example, we have not made as much progress as planned in the development of global guidelines for responsible network roll-out. Individual operating companies already have standards and guidelines in place but introducing consistent global guidelines across a wide variety of cultural practices and differing regulatory frameworks has proved very complex. We are determined to continue work in this area and will report progress next year. Our engagement processes, and our approach to these issues, are described in detail in our Group CSR Report for 2003/04 and on our web-site www.vodafone.com/responsibility. Data systems supporting our report have been reviewed by Deloitte & Touche LLP, and our CSR management practices have been assessed and benchmarked by consultants, csrnetwork. Their reports can be found within the Group CSR report.

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Energy conservation in Egypt
Since 1999, Vodafone Egypt has developed 70 base station sites which are powered by solar power, reducing greenhouse gas emissions.

Be a responsible business

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From left to right above

Ken Hydon
Financial Director

Ken Hydon, Financial Director, aged 59, has been a member of the Board of directors since 1985. He is a Fellow of the Chartered Institute of Management Accountants, the Association of Chartered Certified Accountants and the Association of Corporate Treasurers. He is a director of several subsidiaries of the Company and is a member of the Board of Representatives of the Verizon Wireless partnership in the United States. Ken Hydon has recently been appointed a non-executive director of Reckitt Benckiser Plc and Tesco Plc. He will retire from the board on conclusion of the AGM in 2005.

Peter Bamford
Chief Marketing Officer

Peter Bamford, Chief Marketing Officer, aged 50, has been a member of the Board of directors since April 1998. He is responsible for the full range of marketing and commercial activities including brand, product development, content management, Partner Networks and global accounts. He is also responsible for the Group s operations in the UK & Ireland. Previously, he was Chief Executive, Northern Europe, Middle East & Africa Region. He was Managing Director of Vodafone UK until April 2001. Before joining Vodafone in 1997, Peter Bamford held senior positions with Kingfisher plc and Tesco Plc, and was a director of WH Smith Group Plc.

Arun Sarin
Chief Executive

Arun Sarin, Chief Executive, aged 49, has been a member of the Board of directors since June 1999 and is a member of the Nominations and Governance Committee. He was a director of AirTouch from July 1995 and was President and Chief Operating Officer from February 1997 to June 1999. He was Chief Executive Officer for the United States and Asia Pacific region until 15 April 2000, when he became a non-executive director. He was appointed Chief Executive after the AGM on 30 July 2003. Arun Sarin joined Pacific Telesis Group in San Francisco in 1984 and has served in many executive positions in his 20 year career in telecommunications. He has also served as a director of The Gap, Inc., The Charles Schwab Corporation and Cisco Systems, Inc.

Julian Horn-Smith
Group Chief Operating Officer

Julian Horn-Smith, Group Chief Operating Officer, aged 55, has been a member of the Board of directors since June 1996. He was appointed Group Chief Operating Officer on 1 April 2001, having been Chief Executive of Vodafone s Continental Europe businesses and a director of several of the Group s overseas operating companies. He is responsible for ensuring the operating performance of Group businesses. Julian Horn-Smith is the Chairman of the Supervisory Board of Vodafone Deutschland GmbH and is a non-executive director of Smiths Group Plc.

Vittorio Colao
Chief Executive, Southern Europe, Middle East & Africa Region

Vittorio Colao, Chief Executive, Southern Europe, Middle East & Africa Region, aged 42, joined the Board of directors on 1 April 2002. He has had responsibility for the Group s businesses in Southern Europe since April 2001. He spent the early part of his career at McKinsey & Co, where he was a Partner, before joining Omnitel Pronto Italia S.p.A. as its Chief Operating Officer. In 1999, he became the Chief Executive Officer of Omnitel Pronto Italia SpA (now operating as Vodafone Italy). Vittorio Colao is currently a member of the Aspen Institute and non-exectutive director of RAS Insurance in Italy.

Thomas Geitner
Chief Technology Officer

Thomas Geitner, Chief Technology Officer, aged 49, has been a member of the Board of directors since May 2000. He is responsible for Group Technology & Business Intergration and will be leading the implementation of a standardised architecture for business processes, Information Technology and network systems. Prior to joining the Group, he was a member of the Management Board of RWE AG. Thomas Geitner is a member of the Management Board of Vodafone Holding GmbH and Vodafone Deutschland GmbH and a member of the supervisory board of Singulus Technologies AG.

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Your Board of Directors

Lord MacLaurin of Knebworth, DL
Chairman

Lord MacLaurin of Knebworth, DL, aged 67, has been a member of the Board of directors since January 1997. He is Chairman of the Nominations and Governance Committee and a member of the Remuneration Committee. Lord MacLaurin was Chairman of Tesco Plc from 1985 to 1997 and has been a director of Enterprise Oil Plc, Guinness Plc, National Westminster Bank Plc and Whitbread Plc.

Paul Hazen
Deputy Chairman

Paul Hazen, aged 62, has been a member of the Board of directors since June 1999 and became Deputy Chairman and the Board s nominated senior non-executive director in May 2000. He is Chairman of the Audit Committee and a member of the Nominations and Governance Committee. He became a director of AirTouch in April 1993. In 2001, he retired as Chairman and Chief Executive Officer of Wells Fargo & Company and its principal subsidiary, Wells Fargo Bank, NA. Paul Hazen is also a director of Safeway, Inc., Willis Group Limited, Xstrata AG and E.piphany and he is Chairman of Accel-KKR.

Dr Michael Boskin
Non-Executive Director

Dr. Michael Boskin, aged 58, has been a member of the Board of directors since June 1999 and is a member of the Remuneration Committee and the Audit Committee. He was a director of AirTouch from August 1996 to June 1999. He has been a Professor of Economics at Stanford University since 1971 and was Chairman of the President s Council of Economic Advisers from February 1989 until January 1993. Dr Boskin is President and CEO of Boskin & Co., an economic consulting company and is also a director of Exxon Mobil Corporation, First Health Group Corp. and Oracle Corporation.

Professor Sir Alec Broers
Non-Executive Director

Professor Sir Alec Broers, aged 65, has been a member of the Board of directors since January 1998 and is a member of the Audit Committee and the Nominations and Governance Committee. He is President of the Royal Academy of Engineering and a former Vice-Chancellor of Cambridge University. He spent many years with IBM and is a Fellow of the Royal Society, the Institute of Electrical Engineers and the Institute of Physics. He is

John Buchanan
Non-Executive Director

John Buchanan, aged 61, has been a member of the Board of directors since April 2003. He is a member of the Audit Committee and, solely for the purposes of relevant legislation, is the Board s appointed financial expert on that Committee. He retired from the Board of BP in 2002 after six years as Group Chief Financial Officer and executive director following a wide-ranging career with the company. He was a member of the United Kingdom

Penny Hughes
Non-Executive Director

Penny Hughes, aged 44, has been a member of the Board of directors since September 1998, and is the Chairman of the Remuneration Committee. She has held posts with The Coca-Cola Company, Next Plc and Body Shop Plc. She has particular expertise in marketing and has developed experience in many human resource areas, including leadership development, motivation and retention. Penny Hughes is a also a Foreign Associate of the US National Academy of Engineering. Professor Sir Alec Broers chairs the Vodafone Group Foundation and the Company s UK pension trustee company. On 1 May 2004 it was announced that Her Majesty the Queen intends to make him a Life Peer in recognition of his contribution to engineering and higher education.

Accounting Standards Board from 1997 to 2001. He is the senior independent director of BHP Billiton plc and a non-executive director of AstraZeneca plc.

member of the advisory committee of Bridgepoint Capital Limited and is a non-executive director of Scandinaviska Enskilda Banken AB, Trinity Mirror Group plc and The Gap, Inc.

Sir David Scholey CBE

Non-Executive Director

Sir David Scholey CBE, aged 68, has been a member of the Board of directors since March 1998. He is a member of the Nominations and Governance Committee and the Audit Committee. He is Chairman of Close Brothers Group plc, a non-executive director of Anglo American plc and Chubb Corporation, USA and is an advisor to UBS AG, Mitsubishi Corporation and IBCA-Fitch. Sir David was formerly a director of the Bank of England and a Governor of the British Broadcasting Corporation. He will retire from the Board on conclusion of the AGM in 2005.

Professor Jürgen Schrempp

Non-Executive Director

Professor Jürgen Schrempp, aged 59, has been a member of the Board of directors since May 2000 and is a member of the Nominations and Governance Committee and Remuneration Committee. He has been Chairman of the Board of Management of DaimlerChrysler AG since 1998. From 1995 until 1998 he was Chairman of the Board of Management of Daimler-Benz AG. He was a member of the Supervisory Board of Mannesmann AG until May 2000. Professor Jürgen Schrempp serves on the supervisory board of Allianz AG and is a member of the Board of directors of Richemont SA and Sasol Ltd.

Luc Vandevelde

Non-Executive Director

Luc Vandevelde, aged 53, was appointed to the Board on 1 September 2003 and is a member of the Remuneration Committee. Chairman of Marks & Spencer Group p.l.c., one of the UK s leading retailers of clothing, foods, homeware and financial services, from 2000 to 2004, he was previously Chairman of Promodes, Vice Chairman of Carrefour, and had held senior European and international roles with Kraft General Foods. Luc Vandevelde is Executive Chairman of Change Capital Partners, a private equity fund, and is a non-executive director of Carrefour SA.

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The Group Executive Committee

The following board members of Vodafone Group Plc are members of the Group Executive Committee:
Arun Sarin (Chairman), Peter Bamford, Vittorio Colao, Thomas Geitner, Julian Horn-Smith, Ken Hydon

Brian Clark
Chief Executive, Asia Pacific Region

Brian Clark, Chief Executive, Asia Pacific Region, aged 55, was appointed to this position, based in Japan, on 1 January 2003. He joined Vodafone in 1997. Prior to joining Vodafone he was Managing Director and Chief Executive Officer of Telkom SA Ltd, South Africa. He is also a non-executive director of National Australia Bank Limited.

Alan Harper
Group Strategy Director

Alan Harper, Group Strategy Director, aged 47, joined Vodafone in 1995 as Group Commercial Director and he subsequently became Managing Director of Vodafone Limited, the UK network operating company. He was appointed Group Strategy Director in July 2000. Prior to joining the Group he held the post of Business Strategy Director with Mercury One2One and senior roles with Unitel and STC Telecoms. He is also a member of the Group Operations Committee and Group Policy Committee, a member of the Vodafone D2 Supervisory Board and Chairman of the Vodafone UK Foundation.

Jürgen von Kuczkowski
Chief Executive, Northern Europe Region

Jürgen von Kuczkowski, Chief Executive, Northern Europe Region, aged 63, was appointed to this position on 1 July 2003. He was previously the Chief Executive, Central Europe Region. He joined Mannesmann Mobilfunk GmbH (now Vodafone D2 GmbH) in October 1990 initially as Director of Sales and Distribution and he became Chief Executive Officer in 1994.

Stephen Scott
Group General Counsel and Company Secretary

Stephen Scott, Group General Counsel and Company Secretary, aged 50, was appointed to this position in the Group in 1991, prior to which he was employed in the Racal Group legal department, having moved into industry in 1980 from private law practice in London. He is a director of the Company s UK pension trustee company and insurance companies and is a member of the Group Policy Committee.

Phil Williams
Group Human Resources Director

Phil Williams, Group Human Resources Director, aged 53, was appointed to this position in the Group in 1989. In addition to his Human Resources responsibilities, he is the senior Vodafone nominated director on the Board of Vodacom Group (Pty) Limited, the Group's South African associate company. He is also a director of several Group companies, a director of the Group Foundation and the UK pension trustee company. He is a member of the Group Policy Committee. Prior to joining the Group, he was Personnel Director with Costain and Burmah Castrol.

Independent Auditors Statement to the Members of Vodafone Group Plc

We have examined the Annual Review & Summary Financial Statement which comprises the Summary Directors Report, Summary of the Board s Report to Shareholders on Directors Remuneration, Summary Consolidated Profit and Loss Account, Summary Consolidated Statement of Recognised Gains and Losses, Summary Consolidated Balance Sheet, Summary Consolidated Cash Flow and notes 1 to 4 to the Annual Review & Summary Financial Statement.

This report is made solely to the Company s members, as a body, in accordance with section 251 of the Companies Act 1985. Our work has been undertaken so that we might state to the Company s members those matters we are required to state to them in an auditors report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company s members as a body, for our audit work, for this report, for our audit report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Review & Summary Financial Statement in accordance with applicable United Kingdom law. Our responsibility is to report to you our opinion on the consistency of the Summary Financial Statement within the Annual Review & Summary Financial Statement with the Annual Report for the year ended 31 March 2004, and its compliance with the relevant requirements of section 251 of the Companies Act

1985 and the regulations made thereunder. We also read the other information contained in the Annual Review & Summary Financial Statement as described in the contents section, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Annual Review & Summary Financial Statement.

Basis of opinion

We conducted our work in accordance with bulletin 1999/6 *The Auditors Statement on the Summary Financial Statement* issued by the Auditing Practices Board for use in the United Kingdom.

Opinion

In our opinion, the Annual Review & Summary Financial Statement is consistent with the Annual Report of Vodafone Group Plc for the year ended 31 March 2004 and complies with the applicable requirements of section 251 of the Companies Act 1985, and the regulations made thereunder.

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors

London

25 May 2004

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Summary Directors Report

The Summary Directors Report, the Summary of the Board s Report to Shareholders on Directors Remuneration on pages 27 to 30, and the Summary Financial Statement on pages 32 to 36, are a summary of the information contained in the Vodafone Group Plc Annual Report for the year ended 31 March 2004. This is intended to simplify annual communication with shareholders. This Annual Review & Summary Financial Statement does not contain sufficient information to allow a full understanding of the results of the Vodafone Group and the state of affairs of the Company and the Vodafone Group.

For more detailed information, the Directors Report, the full accounts and the Auditors Report on those accounts, which was unqualified, contained in the Vodafone Group Plc Annual Report for the year ended 31 March 2004, should be consulted. It is available to view on the Company s website at www.vodafone.com

Shareholders wishing to receive the Annual Report as well as the Annual Review & Summary Financial Statement in future years should write to the Registrars at the address on page 41. ADS holders should write to The Bank of New York at the address on page 41.

Corporate governance

The directors of the Company support high standards of corporate governance, which are critical to business integrity and to maintaining investors trust in the Company. The Company s Business Principles (the Business Principles) define its relationships with its stakeholders and govern how Vodafone conducts its business. Amongst other things, the Business Principles state that the Company expects all its employees to act with honesty, integrity and fairness. The Company also promotes the Business Principles to its associate companies (where Vodafone holds a minority stake) and to its business partners and suppliers.

The Combined Code on corporate governance appended to the UK Listing Authority s Listing Rules requires companies listed on the London Stock Exchange to make a disclosure statement on the application of the principles of and compliance with the provisions of good governance set out in the Combined Code. During the year, the Financial Reporting Council, which is responsible for maintaining the Combined Code, approved a revised Combined Code taking into account the recommendations of the Higgs Review of the role and effectiveness of non-executive directors and a separate report by Sir Robert Smith in relation to Audit Committees. The revised Combined Code is effective for companies financial periods beginning on or after 1 November 2003, and therefore, for the Company, will apply from the financial year beginning on 1 April 2004. For the financial year ended 31 March 2004, the directors confirm that the Company has been in compliance with the provisions of the Combined Code effective for that accounting period.

The Company s American Depositary Shares are listed on the New York Stock Exchange (NYSE) and the Company is therefore subject to the rules of the NYSE as well as US securities laws and the rules of the US Securities and Exchange Commission (SEC). In July 2002, the US Congress passed the Sarbanes-Oxley Act which, together with consequent adoption of new rules by the SEC, has introduced a number of changes to the corporate governance requirements on both US domestic companies and non-US registered issuers such as the Company. During 2003, the Company established a Disclosure Committee with

responsibility for reviewing and approving controls and procedures over the public disclosure of financial and related information, and other procedures necessary to enable the Chief Executive and Financial Director to provide their Certifications of the Annual Report. The Company also adopted a corporate code of ethics for senior financial officers, separate from and additional to the Business Principles. The code of ethics and the Business Principles are available on the Company s website at www.vodafone.com

The Company has already begun the work required to ensure compliance with section 404 of the Sarbanes-Oxley Act, which will be required in its financial year ending 31 March 2006.

Further information, including a description of how the Company s corporate governance practices measure against the revised Combined Code, is included in the report on Corporate Governance in the Vodafone Group Plc Annual Report for the year ended 31 March 2004.

Directors

Details of the current members of the Board of directors are shown on pages 22 and 23. Sir Christopher Gent retired as a director at the conclusion of the Annual General Meeting held on 30 July 2003. Luc Vandevelde joined the Board on 1 September 2003.

Committees of the Board

The standing Board committees are the Audit Committee, the Nominations and Governance Committee and the Remuneration Committee. Information regarding the activities of these committees can be found in the report on Corporate Governance in the Annual Report of Vodafone Group Plc for the year ended 31 March 2004. The composition and terms of reference of these committees are published on the Company s website at www.vodafone.com

Review of the Group s business

The Group is involved principally in the provision of mobile telecommunications services. A review of the development of the business of the Company and its subsidiary, joint venture and associated undertakings is contained elsewhere in this Annual Review.

Dividends

The directors have proposed a final dividend for the year of 1.0780 pence per ordinary share, payable on 6 August 2004 to shareholders on the register of members at close of business on 4 June 2004. An interim dividend of 0.9535 pence per ordinary share was paid during the year, producing a total for the year of 2.0315 pence per ordinary share, a total of approximately £1.4 billion. The Company operates a dividend reinvestment plan, further details of which can be obtained from the Company s registrars, telephone +44 (0)870 702 0198.

Subsequent events

Details of material subsequent events are contained on page 19.

Directors interest in the shares of the Company

The Summary Board Report to Shareholders on Directors Remuneration is on pages 27 to 30 of this Annual Review and contains details of the directors interests in the Company s shares.

Corporate Social Responsibility

An overview of the Group s corporate social responsibity activities is set out on page 20 of this Annual Review. A summary of the Group s corporate social responsibility policy is contained in the separate Vodafone Group CSR Report 2003/04, which is available to view on the Company s website at www.vodafone.com

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Build the best global Vodafone team

Global Leadership Programme members in Newbury

The Global Leadership Programme aims to identify and develop talented Vodafone people from around the Group early in their careers who have the potential to become general managers of the future. It offers multifunctional and international experience as well as formal development through an MBA programme.
Our goal is to build the best global team of people who want to lead and inspire others.

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Summary of the Board s Report to Shareholders on Directors Remuneration

Introduction

The Board has delegated to the Remuneration Committee the assessment and recommendation of policy on remuneration for executive directors. The Committee is chaired by Penny Hughes and its members are Lord MacLaurin, Dr Michael Boskin, Professor Jürgen Schrempp and Luc Vandevelde.

Remuneration policy

At the 2002 AGM, shareholders approved a new remuneration policy (the Policy). The Policy was finalised after extensive consultation with shareholders and institutional bodies. This year the Chairman and Chairman of the Remuneration Committee again discussed remuneration matters with the Company s major shareholders and institutions to keep them informed of the Company s position.

>

Shore Community Bank

Toms River NJ

Highlands Bancorp, Inc.

Vernon NJ

Solvay Bank Corporation

Solvay NY

Hilltop Community Bancorp, Inc.

Summit NJ

Somerset Hills Bancorp

Bernardsville NJ

Honat Bancorp, Inc.

Honesdale PA

Somerset Trust Holding Company

Somerset PA

Hopewell Valley Community Bank

Pennington NJ

Steuben Trust Corporation

Hornell NY

Howard Bancorp, Inc.

Ellicott City MD

Stewardship Financial Corporation

Midland Park NJ

IBW Financial Corporation

Washington DC

Sussex Bancorp

Franklin NJ

Jeffersonville Bancorp

Jeffersonville NY

Tri-County Financial Corporation

Waldorf MD

Jonestown Bank and Trust Co.

Jonestown PA

Turbotville National Bancorp, Inc.

Turbotville PA

JTNB Bancorp, Inc.

Jim Thorpe PA

UNB Corporation

Mount Carmel PA

Juniata Valley Financial Corp.

Mifflintown PA

Union Bancorp, Inc.

Pottsville PA

Kinderhook Bank Corporation

Kinderhook NY

Unity Bancorp, Inc.

Clinton NJ

Kish Bancorp, Inc.

Reedsville PA

VSB Bancorp, Inc.

Staten Island NY

Landmark Bancorp, Inc.

Pittston PA

West Milton Bancorp, Inc.

West Milton PA

Liberty Bell Bank

Marlton NJ

Woodlands Financial Service Company

Williamsport PA

Luzerne National Bank Corporation

Luzerne PA

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ITEM 6 SELECTED FINANCIAL DATA

	For the Year Ended December 31,				
Dollars in thousands, except per share data	**2011**	**2010**	**2009**	**2008**	**2007**
INCOME STATEMENT DATA					
Interest income	**$ 41,832**	$ 44,640	$ 45,812	$ 47,921	$ 51,581
Interest expense	**7,462**	9,623	13,560	18,897	26,561
Net interest income	**34,370**	35,017	32,252	29,024	25,020
Provision for loan losses	**5,435**	6,410	4,750	5,570	500
Net interest income after provision for loan losses	**28,935**	28,607	27,502	23,454	24,520
Other income	**11,737**	12,172	11,703	10,438	10,364
Other expenses	**30,016**	30,303	30,629	26,071	25,030
Income before income taxes	**10,656**	10,476	8,576	7,821	9,854
Applicable income taxes	**2,154**	2,057	1,357	1,077	1,917
Net income	**$ 8,502**	$ 8,419	$ 7,219	$ 6,744	$ 7,937
BALANCE SHEET DATA (AT YEAR-END)					
Assets	**$ 1,004,823**	$ 968,667	$ 961,904	$ 976,679	$ 926,665
Securities	**219,259**	200,774	219,929	252,536	290,496
Loans, net	**678,986**	650,039	632,706	630,330	542,354
Deposits	**782,795**	746,526	728,523	690,297	670,640
Borrowings	**117,153**	120,585	135,585	190,404	161,012
Stockholders' equity	**97,474**	93,754	88,303	84,439	85,130
COMMON SHARE DATA*					
Earnings per share basic	**$ 1.43**	$ 1.42	$ 1.22	$ 1.13	$ 1.32
Cash dividends paid	**0.76**	0.76	0.76	0.76	0.76
Book value per share	**16.39**	15.81	14.90	14.18	14.21
Weighted average number of common shares	**5,936,030**	5,928,343	5,936,001	5,988,525	5,990,943
Dividend payout ratio	**53.15%**	53.52%	62.50%	67.47%	57.52%
PROFITABILITY RATIOS AND CONDITION					
Return on average assets	**0.85%**	0.86%	0.75%	0.72%	0.81%
Return on average equity	**8.80%**	9.15%	8.34%	7.96%	9.83%
Average stockholders' equity to average assets	**9.72%**	9.40%	8.99%	9.10%	8.23%
SELECTED ASSET QUALITY RATIOS					
Non-performing loans to total loans	**2.02%**	2.35%	2.39%	1.52%	0.41%
Net charge-offs to average loans outstanding	**0.77%**	0.47%	0.03%	0.68%	0.00%
Allowance for loan losses to total loans	**2.23%**	2.29%	1.86%	1.16%	1.07%
Allowance for loan losses to non-performing loans	**110.29%**	97.43%	77.72%	76.33%	258.99%

* All amounts restated for the 5% common stock dividend distributed in December 2006 and 2007.

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

INTRODUCTION

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

CRITICAL ACCOUNTING POLICIES

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

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

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

Accounting Standards Codification (ASC) Topic 350, *Intangibles Goodwill and Other,* requires that goodwill is not amortized to expense, but rather that it be 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 December 31, 2011. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur. 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.

EXECUTIVE OVERVIEW

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

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The Corporation's overall strategy is to increase loan growth in local markets, while maintaining a reasonable funding base by offering competitive deposit products and services. The year 2011 continued to be challenging for many financial institutions with high levels of problem assets, recession in the housing markets, lingering high unemployment, and slow uneven growth. ACNB continued to be profitable and well capitalized despite expenses elevated from the aftershocks of this epic challenge to the United States economy. Lower provision for loan losses, which is still quite high by historic levels, and continued careful spending resulted in increased net income to $8,502,000, or $1.43 per share, in 2011, compared to $8,419,000, or $1.42 per share, in 2010 and $7,219,000, or $1.22 per share, in 2009. Returns on average equity were 8.80%, 9.15% and 8.34% in 2011, 2010 and 2009, respectively.

Because funding costs were near practical floors, they could not be decreased at the same rate of earning assets decreases, therefore the Corporation's net interest margin decreased from 2010 on average to 3.74% in 2011, compared to 3.92% and 3.64% in 2010 and 2009, respectively. Net interest income was $34,370,000 in 2011, as compared to $35,017,000 in 2010 and $32,252,000 in 2009.

Other income was $11,737,000, $12,172,000 and $11,703,000 in 2011, 2010 and 2009, respectively. The largest source of other income is commissions from insurance sales from Russell Insurance Group, Inc. (RIG), which decreased by 3% in 2011 with the effects of lower premium insurance and reduced commercial insurance volume due to economic contractions. In 2011, a $1,000 net gain was recognized on investments compared to net gains of $72,000 in 2010 and $17,000 in 2009. In 2009, the Corporation took an impairment charge of $522,000 on two equity securities that were determined to be other-than-temporarily impaired; no impairment charges occurred in either 2010 or 2011. Income from fiduciary activities totaled $1,396,000 for 2011, as compared to $1,303,000 for 2010 and $1,057,000 for 2009. Trust fiduciary income benefited from continued organic growth in average assets under administration and higher estate settlement fees. Service charges on deposit accounts was stable at $2,418,000 for 2011, and revenue from ATM and debit card transactions increased 10% to $1,236,000 due to higher volume.

Other expenses decreased to $30,016,000, or by 1%, in 2011, as compared to $30,303,000 in 2010. Other expenses totaled $30,629,000 in 2009. The largest component of other expenses is salaries and employee benefits, which decreased 1% to $17,138,000 in 2011 compared to $17,318,000 in 2010, in part due to lower defined benefit pension plan expense. Compared to 2010, occupancy expense decreased 6% in 2011 due to less specific repairs, while equipment expense increased 5% from increased investment in and maintenance on technology assets. Professional services expenses decreased 18% due to strategic initiatives and the subsidiary bank charter conversion during 2010. FDIC and other regulatory expenses decreased by 28% in 2011. Significantly higher expense since 2009 was the result of a requirement of all FDIC-insured banks to restore the Deposit Insurance Fund due to the cost of protecting depositors' accounts at failed banks during the severe recession. A more thorough discussion of the Corporation's results of operations is included in the following pages.

RESULTS OF OPERATIONS

Net Interest Income

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

Net interest income is affected by changes in interest rates, volume of interest bearing assets and liabilities, and the composition of those assets and liabilities. The "interest rate spread" and "net interest margin" are two common statistics related to changes in net interest income. The interest rate spread represents the difference between the yields earned on interest earning assets and the rates paid for interest bearing liabilities. The net interest margin is defined as the percentage of net interest

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income to average earning assets, which also considers the Corporation's net non-interest bearing funding sources, the largest of which are non-interest bearing demand deposits and stockholders' equity.

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

Table 1 Average Balances, Rates and Interest Income and Expense

	2011			2010			2009		
Dollars in thousands	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**	**Average Balance**	**Interest**	**Yield/ Rate**
INTEREST EARNING ASSETS									
Loans	**$ 674,897**	**$ 34,493**	**5.11%**	$ 663,642	$ 36,043	5.43%	$ 646,819	$ 35,626	5.51%
Taxable securities	**184,642**	**6,006**	**3.25%**	176,758	7,181	4.06%	186,403	8,620	4.62%
Tax-exempt securities	**33,681**	**1,252**	**3.72%**	34,470	1,308	3.79%	39,061	1,488	3.81%
Total Securities	**218,323**	**7,258**	**3.32%**	211,228	8,489	4.02%	225,464	10,108	4.48%
Other	**26,826**	**81**	**0.30%**	17,902	108	0.60%	13,829	78	0.56%
Total Interest Earning Assets	**920,046**	**41,832**	**4.55%**	892,772	44,640	5.00%	886,112	45,812	5.17%
Cash and due from banks	**13,556**			14,721			14,771		
Premises and equipment	**13,898**			14,324			14,156		
Other assets	**62,301**			71,180			57,393		
Allowance for loan losses	**(15,369)**			(14,068)			(9,669)		
Total Assets	**$ 994,432**			$ 978,929			$ 962,763		
LIABILITIES AND STOCKHOLDERS' EQUITY									
INTEREST BEARING LIABILITIES									
Interest bearing demand deposits	**$ 138,242**	**$ 115**	**0.08%**	$ 128,835	$ 125	0.10%	$ 114,979	$ 139	0.12%
Savings deposits	**230,221**	**354**	**0.15%**	214,812	445	0.21%	205,899	885	0.43%
Time deposits	**292,381**	**3,988**	**1.36%**	304,891	5,653	1.85%	307,893	8,283	2.69%
Total Interest Bearing Deposits	**660,844**	**4,457**	**0.67%**	648,538	6,223	0.96%	628,771	9,307	1.48%
Short-term borrowings	**43,124**	**91**	**0.21%**	42,849	119	0.28%	46,885	331	0.71%
Long-term borrowings	**76,776**	**2,914**	**3.80%**	85,385	3,281	3.84%	101,260	3,922	3.87%
Total Interest Bearing Liabilities	**780,744**	**7,462**	**0.96%**	776,772	9,623	1.24%	776,916	13,560	1.75%
Non-interest bearing demand deposits	**109,070**			98,862			87,503		
Other liabilities	**8,005**			11,321			11,814		
Stockholders' equity	**96,613**			91,974			86,530		
Total Liabilities and Stockholders' Equity	**$ 994,432**			$ 978,929			$ 962,763		
NET INTEREST INCOME		**$ 34,370**			$ 35,017			$ 32,252	
INTEREST RATE SPREAD			**3.59%**			3.76%			3.42%
NET INTEREST MARGIN			**3.74%**			3.92%			3.64%

For yield calculation purposes, nonaccruing loans are included in average loan balances. Loan fees of $48,000, $52,000 and $90,000 as of December 31, 2011, 2010 and 2009, respectively, are included in interest income. Yields on tax-exempt securities are not tax effected.

Table 1 presents balance sheet items on a daily average basis, net interest income, interest rate spread, and net interest margin for the years ending December 31, 2011, 2010 and 2009. Table 2 analyzes the relative impact on net interest income for changes in the volume of interest earning assets and interest bearing liabilities and changes in rates earned and paid by the Corporation on such assets and liabilities.

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Net interest income totaled $34,370,000 in 2011, as compared to $35,017,000 in 2010 and $32,252,000 in 2009. During 2011, net interest income decreased as a result of lower interest income exceeding lower funding cost due to the inability to lower deposit rates further after several years of continued record low rates and a one-time interest recovery on a large loan in 2010. In addition to this recovery, the increase in net interest income in 2010 was primarily related to a better mix of earning assets and market-driven lower rates on funding.

The net interest margin during 2011 was 3.74% compared to 3.92% during 2010. The margin decreased due to continued decreasing earning asset yields that exceeded decreasing funding costs from lower rates on new or renewed time deposits and lower market rates on savings products. The Federal Open Market Committee repeatedly decreased the federal funds rate from September 2007 to December 2008 and has maintained it at 0% to 0.25% since that time. In addition, the Federal Reserve Bank has embarked on various programs referred to as Quantitative Easing which, in effect, attempted to lower rates on longer term portions of the yield curve. These decreases allowed interest rate reductions on lower-cost transactional deposit products and higher-cost certificates of deposit; the result was a 0.28% decrease in funding costs in 2011. Overtaking the benefit of a lower cost of funds in 2011, however, was earning asset yield declines in the investment portfolio as new purchases were at lower rates, as well as declines in the loan portfolio from existing adjustable rate loans resetting at lower rates based on declines in index rates. The decreased earning asset yields in 2010 were partially offset by interest income of $605,000 on full payoff of a loan that was in nonaccrual status in prior years. This one-time recovery increased earning asset yield and net interest margin by seven basis points (.07%) for the year ended December 31, 2010. Maintaining the net interest margin going forward will be challenged by the fact that substantial amounts of deposits are at practical rate floors, while loans and the investment securities portfolio will most likely continue to decrease in yields. The cost and availability of wholesale funding could also be affected by a variety of internal and external factors resulting from the creditworthiness of the Corporation and the credit providers.

Average earning assets were $920,046,000 in 2011, an increase of 3.1% from the balance of $892,772,000 in 2010, which was an increase from $886,112,000 in 2009. Loan growth represented the largest increase in average assets in 2011, along with smaller increases in the investment portfolio and interest bearing deposits. Loan growth in 2010 was partially offset by decreases in the investment portfolio. Average interest bearing liabilities were $780,774,000 in 2011, up from $776,772,000 in 2010 after a slight decrease from $776,916,000 in 2009. Average non-interest bearing demand deposits increased 10.3%, continuing the trend upward for 2010 and 2009. This increase was attributed to new relationships and the value placed on FDIC insurance by depositors. On average, deposits (including non-interest bearing) were up 3.0%, while borrowings decreased by 6.5% as a result of funds available from deposit increases. Lower-cost transaction and savings deposits grew while time deposits decreased in 2011, continuing a trend started in 2008. This trend is attributed to depositors favoring liquidity in a generally low rate environment.

The rate/volume analysis detailed in Table 2 shows that the decrease in net interest income in 2011 was due to earning asset rate decreases exceeding funding cost rate decreases. Earning asset yields declined due to new purchases at lower rates in the investment portfolio and declines in the loan portfolio from existing adjustable rate loans resetting at lower rates and new lower-rate originations replacing loan amortizations at higher rates. In 2011, the decrease in interest income was 30% higher than the decrease in interest expense. Interest expense decreased due to less time deposit and borrowed fund volume and rate decreases in all interest bearing liability categories. Favorable rate changes resulting in less interest expense in 2010, as compared to 2009, were only partially offset by decreased volume in securities assets and loan rate decreases from loans resetting or originated at lower rates in 2010.

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

Table 2 Rate/Volume Analysis

	2011 versus 2010			2010 versus 2009		
	Due to Changes in			Due to Changes in		
In thousands	Volume	Rate	Total	Volume	Rate	Total
INTEREST EARNING ASSETS						
Loans	**$ 603**	**$ (2,153)**	**$ (1,550)**	$ 918	$ (501)	$ 417
Taxable securities	**309**	**(1,484)**	**(1,175)**	(430)	(1,009)	(1,439)
Tax-exempt securities	**(30)**	**(26)**	**(56)**	(174)	(6)	(180)
Total Securities	**279**	**(1,510)**	**(1,231)**	(604)	(1,015)	(1,619)
Other	**40**	**(67)**	**(27)**	24	6	30
Total	**$ 922**	**$ (3,730)**	**$ (2,808)**	$ 338	$ (1,510)	$ (1,172)
INTEREST BEARING LIABILITIES						
Interest bearing demand deposits	**$ 9**	**$ (19)**	**$ (10)**	$ 15	$ (29)	$ (14)
Savings deposits	**30**	**(121)**	**(91)**	37	(477)	(440)
Time deposits	**(224)**	**(1,441)**	**(1,665)**	(80)	(2,550)	(2,630)
Short-term borrowings	**1**	**(29)**	**(28)**	(26)	(186)	(212)
Long-term borrowings	**(327)**	**(40)**	**(367)**	(610)	(31)	(641)
Total	**(511)**	**(1,650)**	**(2,161)**	(664)	(3,273)	(3,937)
Change in Net Interest Income	**$ 1,433**	**$ (2,080)**	**$ (647)**	$ 1,002	$ 1,763	$ 2,765

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

Provision for Loan Losses

The provision for loan losses charged against earnings was $5,435,000 in 2011, as compared to $6,410,000 in 2010 and $4,750,000 in 2009. ACNB adjusts the provision for loan losses periodically as necessary to maintain the allowance at a level deemed to meet the risk characteristics of the loan portfolio.

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

Other Income

Other income was $11,737,000 for the year-ended December 31, 2011, a $435,000, or 4%, decrease from 2010. The largest source of other income is commissions from insurance sales from RIG, which decreased 3% to $4,824,000. The decrease was due to lost customers in the economic downturn, increased competition and a soft (low premium) market. "Contingent" commissions were stable, after declining in 2010. The "contingent" or extra commission payments from insurance carriers are mostly received in the first quarter of each year, and the amount is at the discretion of various insurance carriers in accordance with applicable insurance regulations. Heightened competition is expected to continue in this business line and contingent commissions are not predictable.

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In 2011, investment gains of $1,000 were recognized compared to gains of $72,000 in 2010 and $17,000 in 2009. The higher gains in 2010 and 2009 were to adjust the interest rate and credit risk composition of the portfolio by selling selected municipal securities, no sales were made in 2011. The Corporation holds equity investments in the common stock of two bank holding companies headquartered and operating in Pennsylvania. Decreased market prices for these stocks below the acquisition prices resulted in the Corporation taking an impairment charge of $522,000 on these two equity securities during the third quarter of 2009. Based on market values in excess of the subsequent carrying values, additional impairment charges were not necessary in 2011 or 2010.

Income from fiduciary activities, which includes fees from both institutional and personal trust and asset management services and estate settlement services, totaled $1,396,000 for the year-ended December 31, 2011, as compared to $1,303,000 for 2010 and $1,057,000 for 2009. At December 31, 2011, ACNB had total assets under administration of approximately $135,000,000, down 11% from $152,000,000 at the end of 2010 and $138,000,000 at the end of 2009. The increase in income was in part the result of higher estate settlement income in 2011 which varies with specific activity.

Service charges on deposit accounts increased less than 1% to $2,418,000 on varying customer actions. Further, certain government regulations and policies effective in 2010 and 2011 limited service charge increases and make future revenue levels uncertain. Revenue from ATM and debit card transactions increased 10% to $1,236,000 due to higher volume. The increase resulted from consumer desire to use more electronic delivery channels; however government actions could result in rate controls on this activity in future years, the effect of which cannot be currently quantified. Fee income from sold mortgages decreased by $222,000, or 47%, due to lower sold mortgage volume.

Impairment Testing

RIG has certain long-lived assets, including purchased intangible assets subject to amortization such as insurance books of business and associated goodwill assets, which are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. Goodwill that 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. That annual assessment date is December 31. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The goodwill impairment analysis is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment. If required, the second step involves calculating an implied fair value of goodwill for the reporting unit for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit to a group of likely buyers whose cash flow estimates could differ from those of the reporting entity, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. Subsequent reversal of goodwill impairment losses is not permitted. ACNB performs an annual evaluation to determine if there is goodwill impairment. As noted above, commissions from insurance sales decreased 3% although RIG's stand alone net income increased by 50% in 2011 compared to 2010 boosted by expense savings and elimination of management fees to the holding company. As the testing for potential impairment involves methods that include both current and projected income amounts, the fair value increased at December 31, 2011, as compared to previous years' impairment testing results.

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

Other Expenses

Other expenses decreased 1% to $30,016,000 for the year ended December 31, 2011. The largest component of other expenses is salaries and employee benefits, which fell 1% to $17,138,000 compared to $17,318,000 in 2010. The reasons for the decrease in salaries and employee benefits expenses include the following:

- decreased defined benefit pension expense due to prior year plan investment performance and the reduced benefit formula implemented by the Corporation on January 1, 2010,
- stable other benefit plan costs, particularly medical insurance, and
- lower production-based commissions and incentives, offset by
- increases from higher employee usage of 401(k) plan benefits including the employer match and compliance cost, and payroll taxes,
- normal merit increases to employees, and
- an increase in the number of full-time equivalent employees.

Salaries and employee benefits decreased $362,000 or 2% from 2009 to 2010. The decreased expense was due primarily to a significantly lower defined benefit pension expense in 2010 from better return on plan assets in 2009 after the severe downturn in return in 2008.

The Corporation reduced the benefit formula for the defined benefit pension plan effective January 1, 2010, in order to manage total benefit costs. The Corporation's overall investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of asset types, fund strategies, and fund managers. The mix of investments is adjusted periodically by retaining an advisory firm to recommend appropriate allocations after reviewing the Corporation's risk tolerance on contribution levels, funded status, plan expense, as well as any applicable regulatory requirements. However, the determination of future benefit expense is also dependent on the fair value of assets and the discount rate on the year-end measurement date; specifically, with low discount rates and fair value volatility, the expense will be negatively impacted in 2012 by the historically low rates at the latest measurement date and very low plan return in 2011.

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Net occupancy expense was $2,043,000 in 2011, $2,197,000 in 2010, and $2,281,000 in 2009. Equipment expense totaled $2,620,000 during 2011, as compared to $2,499,000 during 2010 and $2,175,000 during 2009. Occupancy was lower in 2011 due to lower repair and real estate tax expenditures; equipment expenses increased in 2011 due to new technology purchases and the related maintenance. Equipment expenses are subject to ever increasing technology demands and the need for systems reliability in a digital age. The majority of the expense increase in 2010 from 2009 was a result of various technology upgrades.

Professional services expense totaled $911,000 for 2011, as compared to $1,116,000 for 2010 and $860,000 for 2009. Increased expense in 2010 included legal expense associated with problem loans and a series of strategic initiatives that included converting the subsidiary bank to a state charter, listing ACNB Corporation on the NASDAQ Stock Market, and work on the Dividend Reinvestment and Stock Purchase Plan. Other tax expenses increased slightly in 2011 compared to 2010 due to an increased capital base at the Bank. Supplies and postage expenses decreased in 2011 compared to the two prior years due to customers' increased use of electronic transaction channels.

Marketing expenses increased 4% during 2011 due to expenses related to a new community office and various product promotions. In 2010, marketing expenses were higher than in 2009 due in part to communications regarding the subsidiary bank's change to a state charter.

FDIC and regulatory expense for 2011 was $1,026,000, a decrease of $408,000 from $1,434,000 in 2010. FDIC and regulatory expense in 2009 was $1,958,000. Part of the decrease was due to the subsidiary Bank's conversion to a state charter which resulted in continued rigorous state and federal examination processes, but at a lower cost. Despite the decrease in 2011 and 2010, FDIC expense for all years presented was much higher than periods before the severe financial crisis. The much higher expense was required of all FDIC-insured banks to restore the deposit insurance fund due to the cost of protecting depositors' accounts at failed banks during this recession. At the end of the third quarter of 2009, the FDIC announced a plan in which most banks prepaid 3.25 years of regular quarterly premiums at year-end 2009, as opposed to a special assessment similar to which was levied in the second quarter of 2009. The prepaid assessment did not immediately affect Bank earnings. Each institution recorded its prepaid assessment as a prepaid expense (an asset) as of December 30, 2009, the date the payment was made. At December 31, 2009, and each quarter thereafter, each institution records an expense for its regular quarterly assessment and an offsetting credit to the prepaid expense until the asset is exhausted. Once the asset is exhausted, the institution will record an accrued expense payable each quarter for the assessment payment, which will be made to the FDIC at the end of the following quarter. Even though an estimated premium is prepaid under this current plan, the actual expense will vary based on several factors including quarter-end deposit levels and risk ratings.

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. Fair values are based on appraisals that consider the sales prices of similar properties in the proximate vicinity less estimated selling costs. Foreclosed real estate expenses were $725,000, $292,000 and $18,000 for years ended December 31, 2011, 2010 and 2009, respectively. The escalating cost was due to the increased number and varying mix of commercial and residential collateral, unpaid property taxes and deferred maintenance required upon acquisition. In addition, some properties suffered decreases in value after acquisition (requiring write-downs to fair value) during prolonged marketing cycles for these distressed properties. The 2011 expense was net of a $194,000 gain on one commercial real estate participation loan in the first quarter. Foreclosed assets held for resale expenses are projected to remain high in 2012 due to the existing inventory of properties and projected additions based on information derived from the estimation process of the allowance for loan losses.

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Other operating expenses increased 5% in 2011 as a result of corporate governance, communications and loan promotion expenditures. Other operating expenses decreased 12% in 2010 from 2009 mainly as a result of cost savings in discretionary expenditures.

Provision for Income Taxes

ACNB recognized income taxes of $2,154,000, or 20.2% of pretax income, during 2011, as compared to $2,057,000, or 19.6%, during 2010 and $1,357,000, or 15.8%, during 2009. The variances from the federal statutory rate are generally due to tax-exempt income (from investments in and loans to state and local units of government at below-market rates, an indirect form of taxation) and investments in low-income housing partnerships (which qualify for federal tax credits).

The increasing effective tax rate during 2011 and 2010 compared to 2009 was a result of increasing pretax income in relationship to stable tax-exempt income. Pretax income increased in 2011 and 2010 due to revenue and expense elements described above.

At December 31, 2011, net deferred tax assets amounted to $1,447,000. Deferred tax assets are realizable primarily through future reversal of existing taxable temporary differences. Management currently anticipates future earnings and capital gains will be adequate to utilize deferred tax assets. Accordingly, no valuation allowance has been established for deferred tax assets at December 31, 2011.

FINANCIAL CONDITION

Average earning assets increased in 2011 to $920,046,000, or by 3%, from $892,772,000 in 2010 following $886,112,000 in 2009. ACNB's investment portfolio increased in 2011 from strong deposit growth after it had decreased in 2010 and 2009 as a result of the planned objective to fund in-market loans and reduce average borrowings. Loans increased 2% and 3% on average in 2011 and 2010, respectively. Besides funds provided by investment pay-downs, growth in loans was funded by increased customer deposits. Average deposits increased in 2011 to $769,914,000 from $747,400,000 in 2010 and $716,274,000 in 2009. Average borrowings decreased in 2011 to $119,900,000 from $128,234,000 in 2010 and $148,145,000 in 2009.

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 increase in the securities portfolio in 2011 was mainly to deploy growth in deposits into available investments that combined the desired combination of yield, liquidity and manageable interest rate risk sensitivity. This process was made more challenging due to the Federal Reserve Bank's program commonly called Quantitative Easing in which, by their open market purchases, the yields are maintained at a lower level than would otherwise be the case. The contraction in the securities portfolio during 2010 was designed to fund increased lending in the earning asset mix, but was also a result of relatively low yields available on investments within the credit quality and interest rate sensitivity targets of ACNB. The investment portfolio is comprised of U.S. Government agency, municipal, and corporate securities. These securities provide the appropriate characteristics with respect to credit quality, yield and maturity relative to the management of the overall balance sheet.

At December 31, 2011, the securities balance included a net unrealized gain on available for sale securities of $5,996,000, net of taxes, on amortized cost of $200,144,000 versus a net unrealized gain of $3,923,000, net of taxes, on amortized cost of $184,787,000 at December 31, 2010. The increase in fair value of available for sale securities during 2011 was a result of a higher amount of investments in the portfolio and changes in the U.S. Treasury yield curve and the spread from this yield curve required by investors on the types of investment securities that ACNB owns. Actions by the Federal Reserve to lower rates on the yield curve most conducive to stimulating the housing market and separate concerns

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about European sovereign debt offset the bonds markets concern about the level of U.S. debt and inflation, leading to generally lower rates in the yield curve, however fair values were volatile on any given day in 2011. The Corporation does not own investments consisting of pools of Alt A or subprime mortgages, private label mortgage-backed securities, or trust preferred investments. The fair values of securities available for sale (carried at fair value) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1) or by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on securities' relationship to other benchmark quoted prices. The Corporation uses a trusted service provider to provide matrix pricing and uses the valuation of another provider to compare the pricing for reasonableness. The Corporation holds equity investments in the common stock of two bank holding companies headquartered and operating in Pennsylvania. Both holding companies continue to pay cash dividends, which was one of the driving forces in the initial investment decision. However, current market prices for these stocks are below the prices paid at the time of acquisition. A review of the factors that may be contributing to these price declines led to a conclusion that the prices on these securities were not likely to recover in the near term and that they were other-than-temporarily impaired. A charge against current earnings of $522,000 was taken in the third quarter of 2009 to write-down the value of these securities. Please refer to Note C "Securities" in the Notes to Consolidated Financial Statements for more information on the security portfolio and Note L "Fair Value Measurements" in the Notes to Consolidated Financial Statements for more information about fair value.

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

Table 3 Investment Securities

In thousands	**2011**	**2010**	**2009**
AVAILABLE FOR SALE SECURITIES AT FAIR VALUE			
U.S. Government and agencies	**$ 40,169**	$ 28,260	$ 24,328
Mortgage-backed securities	**107,527**	114,359	133,497
State and municipal	**46,317**	34,676	41,271
Corporate bonds	**13,379**	11,659	10,174
CRA mutual fund	**1,081**	1,030	
Stock in other banks	**754**	746	602
	209,227	190,730	209,872
HELD TO MATURITY SECURITIES AT AMORTIZED COST			
U.S. Government and agencies	**10,032**	10,044	10,057
	10,032	10,044	10,057
TOTAL	**$ 219,259**	$ 200,774	$ 219,929

Table 4 discloses investment securities at the scheduled maturity date at December 31, 2011. Many securities have call features that make there redemption possible before the stated maturity date.

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Table 4 Securities Maturity Schedule

	1 Year or Less		Over 1 - 5 Years		Over 5 - 10 Years		Over 10 Years or No Maturity		Total	
Dollars in thousands	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**	**Amount**	**Yield**
U.S. Government and agencies	$	%	$ 39,139	2.90%	$ 8,125	2.24%	$ 2,005	5.50%	$ 49,269	2.90%
Mortgage-backed securities					46,596	4.54	55,463	3.80	102,059	4.14
State and municipal	501	4.00	3,777	3.20	30,919	3.67	8,875	3.77	44,072	3.65
Corporate bonds	6,081	6.88	7,024	3.26					13,105	4.94
CRA mutual fund							1,044		1,044	
Stock in other banks							627		627	
	$ 6,582	6.66%	$ 49,940	2.98%	$ 85,640	4.01%	$ 68,014	3.76%	$ 210,176	3.76%

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

Loans

Loans outstanding increased by $29,177,000, or 4.4%, in 2011, as compared to 3% growth experienced in 2010, demonstrating the determined efforts to lend to creditworthy borrowers despite the continued difficult economic conditions. The higher growth was centered in increased commercial purpose loans (both real estate secured and non real estate secured) and in local market residential mortgages, in part offset by continued declines in commercial construction loans. The commercial purpose segments increased $13,500,000 or 5%, during 2011; spread among diverse categories that include farmland secured, loans to local government units, and other types of commercial real estate secured lending. Residential real estate mortgage lending, which include smaller commercial purpose loans secured by the owner's home, increased by $17,900,000 or 5%, to local borrowers who preferred loan types that would not be sold into the secondary mortgage market. Of the $17,900,000 increase, $1,400,000 was residential mortgage loans secured by junior liens or home equity loans, which are also in many cases junior liens. Junior liens inherently have more credit risk by virtue of the fact that another financial institution may have a higher security position in the case of foreclosure liquidation of collateral to extinguish the debt. Generally, foreclosure actions could become more prevalent if the real estate market continues to be weak and property values further deteriorate. Real estate construction loans continued to decline in 2011, down $3,900,000 or 15%, as a result of the weak demand in the residential real estate market and because of stricter underwriting on this type due to the category's credit attributes.

The commercial loan increase was higher in 2010 compared to 2009 as the result of more concentrated efforts by a larger lending staff despite reduced business activity in the market area that hindered new originations, as well as management's decision to not renew certain commercial loans, primarily participation credits in conjunction with other financial institutions, due to perceived potential credit risk.

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Table 5 Loan Portfolio

Loans at December 31 were as follows:

In thousands	2011	2010	2009	2008	2007
Commercial, financial and agricultural	**$ 56,145**	$ 52,676	$ 45,947	$ 59,861	$ 62,844
Real estate:					
Commercial	**236,017**	225,950	209,054	173,926	127,465
Construction	**22,757**	26,635	37,966	48,958	38,370
Residential	**363,798**	345,854	337,342	341,916	310,459
Consumer	**15,751**	14,176	14,378	13,062	9,064
Total Loans	**$ 694,468**	$ 665,291	$ 644,687	$ 637,723	$ 548,202

The repricing range of the loan portfolio and the amounts of loans with predetermined and fixed rates are presented in the table below:

Table 6 Loan Sensitivities

LOANS MATURING

In thousands	Less than 1 Year	1-5 Years	Over 5 Years	Total
Commercial, financial and agricultural	$ 24,379	$ 20,308	$ 11,458	$ 56,145
Real estate:				
Commercial	60,753	139,022	36,242	236,017
Construction	15,353	6,528	876	22,757
Residential	74,620	89,272	199,906	363,798
Total	$ 175,105	$ 255,130	$ 248,482	$ 678,717

LOANS BY REPRICING OPPORTUNITY

In thousands	Less than 1 Year	1-5 Years	Over 5 Years	Total
Commercial, financial and agricultural	$ 16,989	$ 21,328	$ 17,828	$ 56,145
Real estate:				
Commercial	16,639	122,474	96,904	236,017
Construction	12,774	5,915	4,068	22,757
Residential	42,685	84,773	236,340	363,798
Total	$ 89,087	$ 234,490	$ 355,140	$ 678,717
Loans with a fixed interest rate	$ 39,082	$ 32,244	$ 220,537	$ 291,863
Loans with a variable interest rate	50,005	202,246	134,603	386,854
Total	$ 89,087	$ 234,490	$ 355,140	$ 678,717

Most of the Corporation's lending activities are with customers located within the southcentral Pennsylvania and in the northern Maryland area that is contiguous to its Pennsylvania retail banking offices. This region currently and historically has lower unemployment than the U.S. as a whole. Included in commercial real estate loans are loans made to lessors of non-residential dwellings that total $99,700,000, or 14% of total loans, at December 31, 2011. These borrowers are geographically dispersed throughout ACNB's marketplace and are leasing commercial properties to a varied group of tenants including medical offices, retail space, and recreational facilities. Because of the varied nature

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of the tenants, in aggregate, management believes that these loans do not present any greater risk than commercial loans in general. ACNB does not originate or hold subprime mortgages in its loan portfolio.

The Bank has granted loans to certain of its executive officers, directors and their related interests. These loans were made on substantially the same basis, including interests rates and collateral as those prevailing for comparable transactions with other borrowers at the same time. The aggregate amount of these loans was $10,318,000 and $13,367,000 at December 31, 2011 and 2010, respectively. During 2011, $1,939,000 of new loans and advances were extended and repayments totaled $4,988,000. None of these loans were past due, in non-accrual status, or restructured at December 31, 2011.

Asset Quality

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

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

Although materially elevated from several years back, the unemployment rate in ACNB's market area remained below the state and national average during 2011. Additionally, low interest rates, a less volatile local economy, and minimal inflation continued to provide some support to the economic conditions in the area. During 2011, continued contraction in new residential real estate development/construction and general lower economic activity lingered from the recent major recession, challenging the Corporation's marketplace commercial activity. Slower growth areas such as ACNB's marketplace generally do not retract in economic recessions as quickly and as low as other areas of the country, however the recovery from low economic cycles are also generally slower.

Non-performing assets include nonaccrual and restructured loans (troubled debt restructures or TDRs), accruing loans past due 90 days or more, and other foreclosed assets. The accrual of interest on residential mortgage and commercial loans (consisting of commercial and industrial, commercial real estate, and commercial real estate construction loan classes) is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in the process of collection. Consumer loans (consisting of home equity lines of credit and consumer loan classes) are typically charged off no later than 120 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. ACNB occasionally returns nonaccrual loans to performing status when the borrower brings the loan current and performs in accordance with contractual terms for a reasonable period of time. ACNB categorizes a loan as a TDR if it changes the terms of the loan, such as interest rate, repayment schedule or both, to terms that it otherwise would not have granted to a borrower, for economic or legal reasons related to the borrower's financial difficulties. For all periods presented, TDRs were also nonaccrual loans.

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

Table 7 Non-Performing Assets

Dollars in thousands	2011	2010	2009	2008	2007
Nonaccrual loans, including TDRs	**$ 12,846**	$ 14,657	$ 13,308	$ 7,723	$ 854
Accruing loans 90 days past due	**1,191**	997	2,107	1,963	1,404
Total Non-Performing Loans	**14,037**	15,654	15,415	9,686	2,258
Foreclosed real estate	**4,437**	7,859	6,046	625	136
Total Non-Performing Assets	**$ 18,474**	$ 23,513	$ 21,461	$ 10,311	$ 2,394
Ratios:					
Non-performing loans to total loans	**2.02%**	2.35%	2.39%	1.52%	0.41%
Non-performing assets to total assets	**1.84%**	2.43%	2.23%	1.06%	0.26%
Allowance for loan losses to non-performing loans	**110.29%**	97.43%	77.72%	76.33%	258.99%

If interest due on all nonaccrual loans had been accrued at original contract rates, it is estimated that income before income taxes would have been greater by $652,000 in 2011, $464,000 in 2010, and $643,000 in 2009. The decrease in nonaccrual loans is discussed further below.

Impaired loans at December 31, 2011 and 2010, totaled $12,846,000 and $14,657,000, respectively. At December 31, 2011 and 2010, $1,496,000 and $2,143,000, respectively, of the impaired loans were troubled debt restructured loans, which were also classified as nonaccrual. Loans whose terms are modified are classified as troubled debt restructurings if the borrowers have been granted concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve interest rates being granted below current market rates for the credit risk of the loan or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired. The related allowance for loan losses on impaired loans totaled $1,181,000 and $2,059,000, respectively. The decrease in impaired loans was mainly related to loan amounts that were repaid by the borrowers, were charged off or were eliminated by the Corporation taking legal actions to repossess the collateral and then book the fair value of the collateral, less the cost to sell, as foreclosed assets held for resale. Potential problem loans are defined as performing loans that have characteristics that cause management to have doubts as to the ability of the borrower to perform under present loan repayment terms and which may result in the reporting of these loans as non-performing loans in the future. Total additional potential problem loans approximated $10,807,000 at December 31, 2011, compared to $15,560,000 at December 31, 2010.

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. Fair values are based on appraisals that consider the sale prices of similar properties in the proximate vicinity less estimated selling costs. The fair value of $4,437,000 at December 31, 2011, included one economic development real estate project and five commercial use real estate properties totaling $3,135,000. The economic development project has a recorded fair value of $930,000 and is under a sales agreement with conditions. Five other commercial use real estate properties were brought into foreclosed real estate in 2010 or 2011 with an aggregate fair value of $2,205,000. In addition, the fair value of $1,302,000 for foreclosed real estate at December 31, 2011, represented 11 residential real estate single homes, two of which were taken into foreclosed real estate in 2010, the remainder in 2011. All properties are being actively marketed to targeted buyers by external and internal resources. The fair value of $7,859,000 at December 31, 2010, represented one

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commercial real estate participation loan with a fair value of $5,180,000 that was sold in 2011 at a gain of $194,000, and the economic development project, four commercial real estate, and five single homes loans.

Allowance for Loan Losses

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

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

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

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

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

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

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

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

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other potential exposure in the loan portfolio;

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

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

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.

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

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

Table 8 Analysis of Allowance for Loan Losses

	Years Ended December 31,				
Dollars in thousands	**2011**	**2010**	**2009**	**2008**	**2007**
Beginning balance	**$ 15,252**	$ 11,981	$ 7,393	$ 5,848	$ 5,375
Provision for loan losses	**5,435**	6,410	4,750	5,570	500
Loans charged-off:					
Commercial, financial and agricultural	**1,861**	204	221	1,169	6
Real estate	**2,550**	2,049	64	2,815	
Consumer	**832**	928	63	68	39
Total Loans Charged-Off	**5,243**	3,181	348	4,052	45
Recoveries:					
Commercial, financial and agricultural	**34**	2	172	7	14
Consumer	**4**	40	14	20	4
Total Recoveries	**38**	42	186	27	18
Net charge-offs (recoveries)	**5,205**	3,139	162	4,025	27
Ending balance	**$ 15,482**	$ 15,252	$ 11,981	$ 7,393	$ 5,848
Ratios:					
Net charge-offs to average loans	**0.77%**	0.47%	0.03%	0.68%	%
Allowance for loan losses to total loans	**2.23%**	2.29%	1.86%	1.16%	1.07%

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Table 9 Allocation of the Allowance for Loan Losses

	2011		2010		2009		2008		2007	
Dollars in thousands	**Amount**	**Percent of Loan Type to Total Loans**	**Amount**	**Percent of Loan Type to Total Loans**	**Amount**	**Percent of Loan Type to Total Loans**	**Amount**	**Percent of Loan Type to Total Loans**	**Amount**	**Percent of Loan Type to Total Loans**
Commercial, financial and agricultural	**$ 2,582**	**8.1%**	$ 2,074	7.9%	$ 1,539	7.1%	$ 1,383	9.4%	$ 1,204	11.5%
Real estate:										
Commercial	**6,007**	**34.0**	6,346	34.0	4,250	28.1	2,034	27.3	1,226	23.3
Construction	**548**	**3.3**	1,154	4.0	3,086	5.9	1,970	7.7	2,494	7.0
Residential	**3,624**	**52.3**	3,108	44.6	1,693	56.7	1,051	53.6	605	56.6
Consumer	**926**	**2.3**	861	9.5	403	2.2	325	2.0	207	1.6
Unallocated	**1,795**	**N/A**	1,709	N/A	1,010	N/A	630	N/A	112	N/A
Total	**$ 15,482**	**100.0%**	$ 15,252	100.0%	$ 11,981	100.0%	$ 7,393	100.0%	$ 5,848	100.0%

The allowance for loan losses at December 31, 2011, was $15,482,000, or 2.23% of loans, as compared to $15,252,000, or 2.29% of loans, at December 31, 2010. The ratio of non-performing loans plus foreclosed assets to total assets was 1.84% at December 31, 2011, as compared to 2.43% at December 31, 2010.

Loans past due 90 days and still accruing were $1,191,000 and nonaccrual loans were $12,846,000 as of December 31, 2011. Loans past due 90 days and still accruing were $997,000 at December 31, 2010, while nonaccruals were $14,657,000.

Additional information on nonaccrual loans at December 31, 2011 and 2010, follows:

Dollars in thousands	**Number of Credit Relationships**	**Balance**	**Current Specific Loss Allocations**	**Current Year Charge-Offs**	**Location**	**Originated**
December 31, 2011						
Residential real estate developments	**3**	**$ 2,614**	**$**	**$ 1,155**	**In market**	**2006 2010**
Owner occupied commercial real estate	**13**	**6,469**	**43**	**1,196**	**In market**	**1995 2010**
Investment/rental commercial real estate	**5**	**1,544**	**53**	**286**	**In market**	**2003 2010**
Commercial and industrial	**3**	**2,219**	**1,085**	**1,664**	**In market**	**2006 2008**
Total	**24**	**$ 12,846**	**$ 1,181**	**$ 4,301**		
December 31, 2010						
Residential real estate developments	4	$ 4,388	$ 730	$ 1,000	In market	2006
Economic development project*				601	In market	2007
Owner occupied commercial real estate	14	8,291	719		In market	1995 2008
Investment/rental commercial real estate	4	1,004	61	503	In market	2003 2007
Commercial and industrial	1	974	549	30	In market	2007
Total	23	$ 14,657	$ 2,059	$ 2,134		

* Transferred to other real estate owned in the second quarter of 2010.

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 2010 for purposes listed in the classification in the table above.

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The Corporation has two unrelated impaired loans totaling $2,520,000 to finance residential real estate development projects in the Corporation's primary trading area of southcentral Pennsylvania, both of which are in nonaccrual of interest status. The loans have standard terms and conditions including repayment from the sales of the respective properties, and no interest reserves. Both loans were originated during the first half of 2006. One loan matured with the inability of the borrower to fund necessary infrastructure improvements, the Corporation charged down the loan by $2.5 million in 2008 and entered into a forbearance agreement on which the borrower performed until 2010 and then filed bankruptcy. ACNB further wrote down the loan by $1,000,000 in 2010 and $804,000 in 2011 reflecting alternative uses for the property and updated observed declines in fair value, respectively. It was expected that various real estate collateral on this loan would be protected by a fair value bid at sheriff sale in 2011, however such sales were delayed by legal actions and are now expected in 2012, after which ACNB will market the property to the appropriate buyers. On the other larger residential real estate loan, foreclosure has been held in abeyance while allowing the pursuit of a workout plan including providing additional collateral and more targeted marketing of the property. This loan was charged-down by $274,000 in the first quarter of 2011 due to current declines in fair value and subsequently additional paydowns were made by the borrower from sales of collateral in 2011. Because of the 2011 writedowns and principal repayment, there was no specific valuation allowance on these two unrelated loans at December 31, 2011. Two smaller residential real estate development loans totaled $388,000 when added in 2010; one was settled with a charge down of $77,000 and subsequently sold without further loss, the other loan was reduced by collateral sales to $94,000, which is supported by the remaining collateral's current fair value. A third smaller loan in this category was protected by the Bank at sheriff sale in the fourth quarter of 2011, charged down by $87,000 to fair value less the cost to sale to $189,000 and carried in foreclosed assets at December 31, 2011.

In the second quarter of 2009, a $2,200,000 loan to a local economic development corporation was added to nonaccrual status when the loan matured with various sales agreements and grants still pending prior to any further development activity. Subsequent payment reduced the carrying balance to $1,848,000. Foreclosure processes commenced in the fourth quarter of 2009, and sheriff sale in the first quarter of 2010 resulted in ACNB protecting its interest with a fair value bid. The property was charged down by $601,000 based on an updated appraisal and transferred into foreclosed assets held for resale in 2010.

Included in impaired commercial and industrial loans is a fully-disbursed line of credit originated in the second quarter of 2007 for a start-up enterprise in the food industry in southcentral Pennsylvania totaling $234,000 with no specific valuation allowance at December 31, 2011, which is net of a $1,000,000 charge-off taken in 2008 and an additional charge-off of $529,000 in 2011. Subsequently, in the third quarter 2011, the borrower entered into an addendum to a prior delinquent forbearance agreement with all required principal forbearance payments made by the borrower. This loan, with standard terms and conditions including repayment from conversion of trade assets continues in default and in nonaccrual status. A second credit to an unrelated borrower was added in the third quarter of 2011 in the amount of $1,967,000 with a specific allocation of $1,085,000 and net of a confirmed loss of $1,135,000, which was charged off in the fourth quarter of 2011. This 2006 participation loan was to a company in the building supplies industry that was negatively impacted by the downturn in housing and the more recent loss of a major distributorship. The specific allocation at December 31, 2011, was derived by analyzing the latest borrower provided accounts receivable data, which is the collateral on the loan.

Owner occupied commercial real estate includes 13 loan relationships, 12 of which have balances less than $1,000,000 each in which real estate is collateral and is used in connection with a business enterprise that is suffering economic stress or is out of business. These loans were originated between 1995 and 2010. The largest loan in this category had a balance of $3,508,000 at December 31, 2011, after a partial charge-off of $598,000 in the first quarter of 2011 due to uncertainty of when further legal collection could proceed. Subsequent to December 31, 2011, this loan was settled with a $250,000 recovery of the 2011 charge-off. Another charge-off of $509,000 was taken on an unrelated former loan that was transferred to foreclosed assets held for resale in the second quarter of 2011, where it is valued in the amount of $511,000. The decrease in value was mainly caused by a protracted time period between default and when the Corporation was able to take control of the collateral because of legal actions of the borrower during which the property suffered significant deterioration. The other smaller loans in this category are business loans impacted by the general economic downturn. Collection efforts will continue until it is deemed in the best interest to initiate foreclosure procedures. Two related loans with combined balances of $711,000 had a charge-off of $89,000 before being transferred to foreclosed assets held for resale late in the third quarter of 2011. One loan with a balance of $273,000 had a specific allocation of $43,000 based on a current appraisal less estimated cost to sell.

Investment/rental commercial real estate includes five loan relationships totaling less than $1,000,000 each in outstanding balance in which the real estate is collateral and is used for speculation, rental, or other non-owner occupied uses. These loans were originated between 2003 and 2010. These loans were affected by the lack of borrower cash flow to continue to service the debt and in some cases by increased real estate taxes levied by local government units. The plan is to foreclose and subsequently market the real estate if ongoing workout efforts are not successful. One loan in this category has a specific allocation totaling $53,000 based on the fair value of the related collateral.

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 loan review function and sets the timing and coverage of loan reviews during the year. The results of this independent loan review are included in the systematic review of the loan portfolio. The allowance for loan losses consists of a component for individual loan impairment, primarily based on the loan's collateral fair value and expected cash flow. A watch list of loans is identified for evaluation based on internal and external loan grading and reviews. Loans other than those determined to be impaired are grouped into pools of loans with similar credit risk characteristics. These loans are evaluated as groups with allocations made to the allowance based on historical loss experience adjusted for current trends in delinquencies, trends in underwriting and oversight, concentrations of credit, and general economic conditions within the Corporation's trading area. The provision expense was based on the loans discussed above as well as current trends in the watch list and the local economy as a whole. The charge offs discussed elsewhere in this management discussion and analysis create the recent loss history experience and in the qualitative adjustment which, in turn, affects the calculation of losses inherent in the portfolio. The increase in the provision for loan losses for 2010 compared to 2009 was a result of the measurement of the adequacy of the allowance for loan losses at each period-end. Reasons that the 2010 provision was higher include charge-offs, changes in allocations for specific loans, and continued growth in the loan portfolio during 2010 which caused the amounts assigned to homogeneous pools to increase. The provision for loan losses for 2011 compared to 2010 and 2009 was a result of the measurement of the adequacy of the allowance for loan losses at each period. Reasons that the 2011 was lower included the charge-off of loans with specific allocations provided for in the prior year and favorable changes in the mix and credit classifications on other loans. Reasons that the 2010 provision was higher than 2009 included changes in specific allocations requiring provision expense as well as negative changes in the mix and credit classification on other loans.

Foreclosed Assets Held for Resale

The carrying value of real estate acquired through foreclosure was $4,437,000 at December 31, 2011, compared to $7,859,000 at December 31, 2010. The decrease was mainly due to the full recovery on a commercial use property that had a fair value of $5,180,000, and was collateral on a commercial loan in which the Corporation took a participation interest from another southcentral Pennsylvania bank. Eight other properties were disposed of in 2011. The largest property unsold at December 31,

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2011 was the economic development property described in *allowance for loan losses* section that is under a sales contract with conditions. The largest additions in 2011 were two local commercial real estate properties with fair values of $730,000 and $511,000, respectively, that are being marketed to the appropriate industries. Fourteen additional properties were added and remain unsold between the third quarter of 2010 and December 31, 2011, with an aggregate fair value of $3,196,000. All properties are actively being marketed. The Corporation expects to obtain and market additional foreclosed assets in 2012; however, the total amount and timing is currently not certain.

Other Assets

Other assets decreased $2,978,000, or 16%, in 2011 compared to 2010, primarily because of the decrease in the net funded status of the banking subsidiary's defined benefit pension plan.

Deposits

ACNB relies on deposits as the primary source of funds for lending activities. Average deposits increased 3.0%, or $22,514,000, during 2011, as compared to 4.1% during 2010. ACNB's deposit pricing function employs a disciplined pricing approach based upon alternative funding rates, but also strives to price deposits to be competitive with relevant local competition, including credit unions and larger regional banks. The 2011 deposit growth mix experienced a continued shift to transaction accounts as customers put more value in liquidity and FDIC insurance. Products, such as money market accounts and interest-bearing transaction accounts that had suffered declines in recent years, continued with recovered balances. With persistent low market interest rates in a slow economy, ACNB's ability to maintain and add to its deposit base may be impacted by the reluctance of consumers to accept low rates and by competition willing to pay above market rates to attract market share. Alternatively, if rates rise rapidly and the equity markets would improve, funds could leave the Corporation or be priced higher to maintain.

Table 10 Time Deposits

Maturities of time deposits of $100,000 or more outstanding at December 31, 2011, are summarized as follows:

In thousands		
Three months or less	**$**	**23,513**
Over three through six months		**5,883**
Over six through twelve months		**18,187**
Over twelve months		**33,399**
Total	**$**	**80,982**

Borrowings

Short-term borrowings are comprised primarily of securities sold under agreements to repurchase. As of December 31, 2011, short-term borrowings were $45,962,000, an increase of $6,876,000, or 18%, from the December 31, 2010, balance of $39,086,000. Agreements to repurchase accounts are with the commercial customer base and have attributes similar to core deposits. Investment securities are pledged in sufficient amounts to collateralize these agreements. Compared to year-end 2010, repurchase agreement balances were up $8,699,000, or 23.3%, due to normal fluctuations in the business activities of ACNB's commercial customer base and low competing rates in similar products. At December 31, 2011, there were no short-term FHLB borrowings, due to sufficient deposit funding. Long-term borrowings consist primarily of longer-term advances from the FHLB; in addition, they include a loan from a commercial bank to fund the purchase of RIG. Long-term borrowings totaled

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$71,191,000 at December 31, 2011, versus $81,499,000 at December 31, 2010. The Corporation decreased long-term borrowings by paying off maturing FHLB advances from increased deposits.

In thousands	2011	2010	2009
Amounts outstanding at end of year:			
FHLB overnight advance	**$**	$	$ 5,150
Securities sold under repurchase agreements	**45,962**	37,263	49,504
Treasury tax and loan note		1,823	637
Total	**$ 45,962**	$ 39,086	$ 55,291

Dollars in thousands	2011	2010	2009
Average interest rate at year-end	**0.20%**	0.23%	0.45%
Maximum amount outstanding at any month-end	**$ 56,238**	$ 52,577	$ 55,379
Average amount outstanding	**$ 43,124**	$ 42,849	$ 46,885
Weighted average interest rate	**0.21%**	0.28%	0.71%

Capital

ACNB's capital management strategies have been developed to provide an appropriate rate of return to stockholders, while maintaining its "well capitalized" position. Total stockholders' equity was $97,474,000 at December 31, 2011, compared to $93,754,000 at December 31, 2010. Stockholders' equity increased during 2011 partially due to earnings retained in capital during 2011 and offset by a decrease in accumulated other comprehensive income resulting from the increase in value of the assets in the available for sale investment portfolio offset by declines in the pension plan.

The primary source of additional capital to ACNB is earnings retention, which represents net income less dividends declared. During 2011, ACNB retained $3,990,000, or 47%, of its net income, as compared to $3,913,000, or 46%, in 2010 and $2,707,000, or 37%, in 2009.

On January 24, 2011, the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan was introduced for stockholders of record. This plan provides registered holders of ACNB Corporation common stock with a convenient way to purchase additional shares of common stock by permitting participants in the plan to automatically reinvest cash dividends on all or a portion of the shares owned and to make quarterly voluntary cash payments under the terms of the plan. Participation in the plan is voluntary, and there are eligibility requirements to participate in the plan. As of December 31, 2011, 17,466 shares were issued under this plan with proceeds in the amount of $257,000. Proceeds will be used for general corporate purposes.

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

Quantitative measures established by regulation to ensure capital adequacy require ACNB to maintain minimum amounts and ratios of total and Tier 1 capital to average assets. Management believes, as of December 31, 2011 and 2010, that ACNB's banking subsidiary met all minimum capital adequacy requirements to which it is subject and is categorized as "well capitalized". There are no

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conditions or events since the notification that management believes have changed the banking subsidiary's category.

Table 11 Risk-Based Capital

The banking subsidiary's capital ratios are as follows:

	2011	2010	To be Well Capitalized under Prompt Corrective Action Regulations
Tier 1 leverage ratio (to average assets)	**8.24%**	8.24%	5.00%
Tier 1 risk-based capital ratio (to risk-weighted assets)	**12.07%**	11.99%	6.00%
Total risk-based capital ratio	**13.32%**	13.25%	10.00%

For further information on the actual and required capital amounts and ratios, please refer to Note N of the consolidated financial statements.

Liquidity

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

ACNB's funds are available from a variety of sources, including assets that are readily convertible such as interest bearing deposits with banks, maturities and repayments from the securities portfolio, scheduled repayments of loans receivable, the core deposit base, and the ability to borrow from the FHLB. At December 31, 2011, ACNB could borrow approximately $297,282,000 from the FHLB of which $228,282,000 was available. Because of various restrictions and requirements on utilizing the available balance, ACNB considers $153,000,000 to be the practicable additional borrowing capacity, which is considered to be sufficient for operational needs. The FHLB system is self-capitalizing, member-owned, and its member banks' stock is not publicly traded. ACNB creates its borrowing capacity with the FHLB by granting a security interest in certain loan assets with requisite credit quality. ACNB has reviewed information on the FHLB system and the FHLB of Pittsburgh, and has concluded that they have the capacity and intent to continue to provide both operational and contingency liquidity. The FHLB of Pittsburgh instituted a requirement that a member's investment securities must be moved into a safekeeping account under FHLB control to be considered in the calculation of maximum borrowing capacity. The Corporation currently has securities in safekeeping at the FHLB of Pittsburgh; however, the safekeeping account is under the Corporation's control. As better contingent liquidity is maintained by keeping the securities under the Corporation's control, the Corporation has not moved the securities which, in effect, lowered the Corporation's maximum borrowing capacity. However, there is no practical reduction in borrowing capacity as the securities can be moved into the FHLB-controlled account promptly if they are needed for borrowing purposes.

Another source of liquidity is securities sold under repurchase agreement to customers of ACNB's banking subsidiary totaling $45,962,000 and $37,263,000 at December 31, 2011 and 2010, respectively.

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

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

Aggregate Contractual Obligations

The following table represents the Corporation's on- and off-balance sheet aggregate contractual obligations to make future payments as of December 31, 2011:

In thousands	Less than 1 Year	1 - 3 Years	4 - 5 Years	Over 5 Years	Total
Time deposits	$ 172,158	$ 109,952	$ 7,766	$	$ 289,876
Short term borrowings	45,962				45,962
Long-term debt	21,237	25,517	17,577	6,860	71,191
Operating leases	385	735	548	354	2,022
Payments under benefit plans	133	233	200	3,177	3,743
Total	$ 239,875	$ 136,437	$ 26,091	$ 10,391	$ 412,794

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

Off-Balance Sheet Arrangements

The Corporation is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and, to a lesser extent, standby letters of credit. At December 31, 2011, the Corporation had unfunded outstanding commitments to extend credit of $129,586,000 and outstanding standby letters of credit of $6,230,000. Because these commitments generally have fixed expiration dates and many will expire without being drawn upon, the total commitment level does not necessarily represent future cash requirements. Please refer to Note O of the consolidated financial statements for a discussion of the nature, business purpose, and importance of the Corporation's off-balance sheet arrangements.

New Accounting Pronouncements

During 2011, the Financial Accounting Standards Board (FASB) issued new accounting pronouncements that may impact the Corporation's financial condition or results of operations when adopted. See Note A in the Notes to the Consolidated Financial Statements for a summary of these new accounting pronouncements not yet adopted.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

Interest Rate Risk

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

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

Management endeavors to control the exposure to changes in interest rates by understanding, reviewing and making decisions based on its risk position. The banking subsidiary's asset/liability committee is responsible for these decisions. The Corporation primarily uses the securities portfolio and FHLB advances to manage its interest rate risk position. Additionally, pricing, promotion and product development activities are directed in an effort to emphasize the loan and deposit term or repricing characteristics that best meet current interest rate risk objectives. At present, there is no use of hedging instruments.

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

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

Earnings at Risk

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

The simulation analysis results are presented in Table 13a. These results, as of December 31, 2011, indicate that the Corporation would expect net interest income to decrease over the next twelve months

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by 1.90% assuming an upward ramp in market interest rates of 3.00%, and to decrease by 7.48% if rates ramped downward 3.00%. This profile reflects an acceptable short-term interest rate risk position. A decrease of 3.00% would create an environment in which deposit rates could not practically decline further, thus decreasing net interest income.

Earnings at risk simulations for December 31, 2011, exhibited lower sensitivity in a declining rate environment reflecting an interest rate environment in which larger rate declines could be accommodated.

Value at Risk

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

The net present value analysis results are presented in Table 13b. These results, as of December 31, 2011, indicate that the net present value would increase 3.45% assuming an upward shift in market interest rates of 3.00% and increase 3.67% if rates shifted 1.00% in the same manner.

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

December 31, 2010 Table 13a Net Interest Income Projections		**December 31, 2010 Table 13b Present Value of Equity**	
Changes in Basis Points	**% Change**	**Changes in Basis Points**	**% Change**
(300)	(4.40)%	(300)	(5.10)%
(100)	(0.56)%	(100)	(3.18)%
	%		%
100	(0.35)%	100	0.98 %
300	(0.35)%	300	(2.15)%

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ITEM 8 FINANCIAL STATEMENTS

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated statements of condition of ACNB Corporation and Subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2011. ACNB Corporation's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ACNB Corporation and Subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), ACNB Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 12, 2012 expressed an unqualified opinion.

ParenteBeard LLC
Harrisburg, Pennsylvania
March 12, 2012

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ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CONDITION

Dollars in thousands, except per share data	December 31, 2011	December 31, 2010
ASSETS		
Cash and due from banks	$ 14,423	$ 14,091
Interest bearing deposits with banks	8,200	10,082
Cash and Cash Equivalents	22,623	24,173
Securities available for sale	209,227	190,730
Securities held to maturity, fair value $10,680; $10,671	10,032	10,044
Loans held for sale	337	3,068
Loans, net of allowance for loan losses $15,482; $15,252	678,986	650,039
Premises and equipment	14,483	14,119
Restricted investment in bank stocks	7,146	8,420
Investment in bank-owned life insurance	28,411	27,443
Investments in low-income housing partnerships	3,774	4,124
Goodwill	6,308	5,972
Intangible assets	3,049	3,688
Foreclosed assets held for resale	4,437	7,859
Other assets	16,010	18,988
Total Assets	$ 1,004,823	$ 968,667
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits:		
Non-interest bearing	$ 112,247	$ 103,464
Interest bearing	670,548	643,062
Total Deposits	782,795	746,526
Short-term borrowings	45,962	39,086
Long-term borrowings	71,191	81,499
Other liabilities	7,401	7,802
Total Liabilities	907,349	874,913
STOCKHOLDERS' EQUITY		
Common stock, $2.50 par value; 20,000,000 shares authorized; 6,008,409 and 5,990,943 shares issued; 5,945,809 and 5,928,343 shares outstanding	15,021	14,977
Treasury stock, at cost (62,600 shares)	(728)	(728)
Additional paid-in capital	9,000	8,787
Retained earnings	73,526	69,536
Accumulated other comprehensive income	655	1,182
Total Stockholders' Equity	97,474	93,754
Total Liabilities and Stockholders' Equity	$ 1,004,823	$ 968,667

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

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ACNB CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

Dollars in thousands, except per share data	Years Ended December 31, 2011	2010	2009
INTEREST INCOME			
Loans, including fees	**$ 34,493**	$ 36,043	$ 35,626
Securities:			
Taxable	**6,006**	7,181	8,620
Tax-exempt	**1,252**	1,308	1,488
Dividends	**13**	26	38
Other	**68**	82	40
Total Interest Income	**41,832**	44,640	45,812
INTEREST EXPENSE			
Deposits	**4,457**	6,223	9,307
Short-term borrowings	**91**	119	331
Long-term borrowings	**2,914**	3,281	3,922
Total Interest Expense	**7,462**	9,623	13,560
Net Interest Income	**34,370**	35,017	32,252
PROVISION FOR LOAN LOSSES	**5,435**	6,410	4,750
Net Interest Income after Provision for Loan Losses	**28,935**	28,607	27,502
OTHER INCOME			
Service charges on deposit accounts	**2,418**	2,415	2,402
Income from fiduciary activities	**1,396**	1,303	1,057
Earnings on investment in bank-owned life insurance	**968**	1,002	1,011
Gain on life insurance proceeds		78	
Gains on sales/calls of securities	**1**	72	17
Impairment charges on equity securities			(522)
Service charges on ATM and debit card transactions	**1,236**	1,124	1,002
Commissions from insurance sales	**4,824**	4,949	5,484
Other	**894**	1,229	1,252
Total Other Income	**11,737**	12,172	11,703
OTHER EXPENSES			
Salaries and employee benefits	**17,138**	17,318	17,680
Net occupancy	**2,043**	2,197	2,281
Equipment	**2,620**	2,499	2,175
Professional services	**911**	1,116	860
Other tax	**803**	791	665
Supplies and postage	**640**	717	688
Marketing	**478**	458	430
FDIC and regulatory	**1,026**	1,434	1,958
Intangible assets amortization	**641**	641	638
Foreclosed real estate expenses	**725**	292	18
Other operating	**2,991**	2,840	3,236
Total Other Expenses	**30,016**	30,303	30,629

Income before Income Taxes	**10,656**	10,476	8,576
PROVISION FOR INCOME TAXES	**2,154**	2,057	1,357
Net Income	**$ 8,502**	$ 8,419	$ 7,219
PER SHARE DATA			
Basic earnings	**$ 1.43**	$ 1.42	$ 1.22
Cash dividends declared	**$ 0.76**	$ 0.76	$ 0.76

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

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ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 2011, 2010 and 2009

Dollars in thousands	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
BALANCE JANUARY 1, 2009	$ 14,977	$ (442)	$ 8,787	$ 62,916	$ (1,799)	$ 84,439
Comprehensive income:						
Net income				7,219		7,219
Other comprehensive income, net of taxes					1,443	1,443
Total Comprehensive Income						8,662
Treasury stock purchased (27,600 shares)		(286)				(286)
Cash dividends declared				(4,512)		(4,512)
BALANCE DECEMBER 31, 2009	14,977	(728)	8,787	65,623	(356)	88,303
Comprehensive income:						
Net income				8,419		8,419
Other comprehensive income, net of taxes					1,538	1,538
Total Comprehensive Income						9,957
Cash dividends declared				(4,506)		(4,506)
BALANCE DECEMBER 31, 2010	14,977	(728)	8,787	69,536	1,182	93,754
Comprehensive income:						
Net income				**8,502**		**8,502**
Other comprehensive loss, net of taxes					**(527)**	**(527)**
Total Comprehensive Income						**7,975**
Common stock shares issued (17,466 shares)	**44**		**213**			**257**
Cash dividends declared				**(4,512)**		**(4,512)**
BALANCE DECEMBER 31, 2011	**$ 15,021**	**$ (728)**	**$ 9,000**	**$ 73,526**	**$ 655**	**$ 97,474**

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

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ACNB CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
In thousands	**2011**	**2010**	**2009**
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	**$ 8,502**	$ 8,419	$ 7,219
Adjustments to reconcile net income to net cash provided by operating activities:			
Net (gain) loss on sales of loans and foreclosed real estate, net of write-downs on foreclosed real estate	**38**	(275)	(502)
Earnings on investment in bank-owned life insurance	**(968)**	(1,002)	(1,011)
Impairment charges on equity securities			522
Gain on sales/calls of securities	**(1)**	(72)	(17)
Gain on life insurance proceeds		(78)	
Depreciation and amortization	**2,218**	2,342	2,281
Provision for loan losses	**5,435**	6,410	4,750
Net amortization (accretion) of investment securities premiums (discounts)	**682**	150	(173)
Decrease (increase) in interest receivable	**(257)**	241	565
Decrease in interest payable	**(238)**	(455)	(924)
Mortgage loans originated for sale	**(15,414)**	(38,877)	(51,562)
Proceeds from loans sold to others	**18,403**	36,394	52,952
(Increase) decrease in other assets	**3,857**	(5,872)	(3,845)
Increase (decrease) in other liabilities	**(4,103)**	1,583	158
Net Cash Provided by Operating Activities	**18,154**	8,908	10,413
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from maturities of investment securities available for sale	**55,804**	67,442	71,407
Proceeds from sales of investment securities available for sale		6,561	2,956
Purchase of investment securities available for sale	**(71,830)**	(55,356)	(31,403)
Purchase of investments held to maturity			(10,064)
Redemption of restricted investment in bank stocks	**1,274**	750	
Net increase in loans	**(37,672)**	(26,620)	(12,762)
Purchase of bank-owned life insurance		(250)	(100)
Insurance agency acquisitions, net of cash acquired	**(336)**	(31)	(43)
Proceeds from life insurance death benefits		295	
Capital expenditures	**(1,942)**	(1,089)	(1,951)
Proceeds from sale of property and foreclosed real estate	**6,416**	928	151
Net Cash Provided by (Used in) Investing Activities	**(48,286)**	(7,370)	18,191
CASH FLOWS FROM FINANCING ACTIVITIES			
Net increase in demand deposits	**8,783**	9,635	11,343
Net increase in time certificates of deposits and interest bearing deposits	**27,486**	8,368	26,883
Net increase (decrease) in short-term borrowings	**6,876**	(16,205)	(28,162)
Proceeds from long-term borrowings		22,000	14,000
Repayments on long-term borrowings	**(10,308)**	(20,795)	(40,657)
Dividends paid	**(4,512)**	(4,506)	(4,512)
Common stock issued	**257**		
Purchase of treasury stock			(286)
Net Cash Provided by (Used in) Financing Activities	**28,582**	(1,503)	(21,391)

Net Increase (Decrease) in Cash and Cash Equivalents		**(1,550)**		35		7,213
CASH AND CASH EQUIVALENTS BEGINNING		**24,173**		24,138		16,925
CASH AND CASH EQUIVALENTS ENDING	**$**	**22,623**	$	24,173	$	24,138
Interest paid	**$**	**7,700**	$	10,078	$	14,484
Income taxes paid	**$**	**1,700**	$	2,300	$	2,700
Loans transferred to foreclosed real estate	**$**	**3,290**	$	2,877	$	5,636

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

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ACNB CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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

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

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

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

Basis of Financial Statements

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

Assets held by the Corporation's Trust Department in an agency or fiduciary capacity for its customers are excluded from the consolidated financial statements since they do not constitute assets of the Corporation. Assets held by the Trust Department amounted to $135,000,000 and $152,000,000 at December 31, 2011 and 2010, respectively. Income from fiduciary activities is recognized on the cash method, which approximates the accrual method.

Certain amounts previously reported have been reclassified, when necessary, to conform to the financial statement presentation for 2011. The reclassification had no effect on net income or stockholders' equity.

The Corporation has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2011, 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. One owner occupied commercial real estate loan had a balance of $3,508,000 at December 31, 2011, after a partial charge-off of $598,000 in the first quarter of 2011 due to uncertainty of when further legal collection could proceed. Subsequent to December 31, 2011 this loan was settled with a $250,000 recovery of the 2011 charge-off.

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates

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

Significant Group Concentrations of Credit Risk

Most of the Corporation's activities are with customers located within southcentral Pennsylvania and northern Maryland. Note C discusses the types of securities in which the Corporation invests. Note D discusses the types of lending in which the Corporation engages. Included in commercial real estate loans are loans made to lessors of non-residential dwellings that total $99,700,000, or 14%, of total loans at December 31, 2011. These borrowers are geographically disbursed throughout ACNB's market place and are leasing commercial properties to a varied group of tenants including medical offices, retail space and recreational facilities. Because of the varied nature of the tenants in aggregate, management believes that these loans do not present any greater risk than commercial loans in general.

Cash and Cash Equivalents

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

Securities

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

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

Restricted Investment in Bank Stocks

Restricted investment in bank stocks, which represents required investments in the common stock of correspondent banks, is carried at cost as of December 31, 2011 and 2010, and consists of common stock in the Atlantic Central Bankers Bank and Federal Home Loan Bank (FHLB). In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Management believes no impairment charge was necessary related to the restricted investment in bank stocks during 2011, 2010 or 2009. However, security impairment analysis is completed quarterly, and the determination that no impairment has occurred during those years is no assurance that impairment may not occur in future periods.

Loans Held for Sale

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

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

Loans

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

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

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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

Allowance for Credit Losses

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses (the "allowance") is established as losses 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 unfunded lending commitment is not material to the consolidated statements.

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

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

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

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

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

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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

The unallocated component of the allowance is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

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

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

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

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 restructuring agreement.

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, continuance of a below market interest rate, or an extension of a loan's stated maturity date. Nonaccrual troubled debt restructurings may be restored to accrual status if principal and interest payments, under the modified terms, are current for a sustained period of time and, based on a well-documented credit evaluation of the borrower's financial condition, there is reasonable assurance of repayment. Loans classified as troubled debt restructurings are generally designated as impaired.

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

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

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

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

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

In underwriting commercial and industrial loans, an analysis is performed to evaluate the borrower's character and capacity to repay the loan, the adequacy of the borrower's capital and 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.

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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

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

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

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

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

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

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

In underwriting one-to-four family residential real estate loans, the Corporation evaluates both the borrower's ability to make monthly payments and the value of the property securing the loan. Properties securing real estate loans made by the Corporation are appraised by independent appraisers. The Corporation generally requires borrowers to obtain an attorney's title opinion or title insurance, as

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

well as fire and property insurance (including flood insurance, if necessary) in an amount not less than the amount of the loan. The Corporation has not engaged in subprime residential mortgage originations.

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

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

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

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

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

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

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

Off-Balance Sheet Credit Related Financial Instruments

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

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are adjusted to the

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

fair value, less costs to sell as necessary. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets.

Premises and Equipment

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

Investments in Low-Income Housing Partnerships

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

Bank-Owned Life Insurance

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

ASC Topic 715, *Compensation Retirement Benefits*, requires a liability to be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability is based on either the post-employment benefit cost for continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. The Corporation's liability is based on the post-employment benefit cost for continuing life insurance. The Corporation incurred approximately $22,000, $48,000, and $45,000 of expense in 2011, 2010, and 2009, respectively, related to this accounting pronouncement.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Income Taxes

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

Current income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

revenues. The Corporation determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

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

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

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

Retirement Plan

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

Net Income per Share

The Corporation has a simple capital structure. Basic earnings per share of common stock is computed based on 5,936,030, 5,928,343 and 5,936,001 weighted average shares of common stock outstanding for 2011, 2010 and 2009, respectively.

Advertising Costs

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

Intangible Assets

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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

ASC Topic 350, *Intangibles Goodwill and Other,* requires that goodwill is not amortized to expense, but rather that it be tested for impairment at least annually. If certain events occur which might indicate goodwill has been impaired, the goodwill is tested when such events occur. Impairment write-downs are charged to results of operations in the period in which the impairment is determined. The Corporation did not identify any impairment on its outstanding goodwill from its most recent testing, which was performed as of December 31, 2011. 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.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Changes in certain assets and liabilities, such as unrealized gains (losses) on securities available for sale and the pension liability, are reported as a separate component of the stockholders' equity section of the statement of condition. Such items, along with net income, are components of comprehensive income.

The components of other comprehensive income (loss) and the related tax effects are as follows:

	Years Ended December 31,		
In thousands	**2011**	**2010**	**2009**
Unrealized holding gains (losses) arising during the period	**$ 3,141**	$ (358)	$ 116
Reclassification adjustment for (gains) losses realized in net income	**(1)**	(72)	505
Net unrealized gains (losses)	**3,140**	(430)	621
Tax effect	**1,067**	147	(211)
	2,073	(283)	410
Change in pension liability	**(3,938)**	2,760	1,565
Tax effect	**1,338**	(939)	(532)
	(2,600)	1,821	1,033
Other Comprehensive Income (Loss)	**$ (527)**	$ 1,538	$ 1,443

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

In thousands	**Unrealized Gains on Securities**	**Pension Liability**	**Accumulated Other Comprehensive Income**
BALANCE DECEMBER 31, 2010	$ 3,923	$ (2,741)	$ 1,182
BALANCE DECEMBER 31, 2011	**$ 5,996**	**$ (5,341)**	**$ 655**

Segment Reporting

The Bank acts as an independent community financial services provider, which offers traditional banking and related financial services to individual business and government customers. Through its branch and automated teller machine networks, the Bank offers a full array of commercial and retail financial services, including the taking of time, savings, and demand deposits; the making of commercial, consumer, and mortgage loans; and the providing of other financial services. Management does not separately allocate expenses, including the cost of funding loan demand, between the

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

commercial, retail and mortgage banking operations of the Bank. As such, discrete financial information for commercial, retail and mortgage banking operations is not available and segment reporting would not be meaningful. See Note S for a discussion of insurance operations.

New Accounting Pronouncements

ASU 2011-03

The Financial Accounting Standards Board (FASB) has issued this Accounting Standard Update (ASU) to clarify the accounting principles applied to repurchase agreements, as set forth by FASB ASC Topic 860, *Transfers and Servicing*. This ASU, entitled "*Reconsideration of Effective Control for Repurchase Agreements*", amends one of three criteria used to determine whether or not a transfer of assets may be treated as a sale by the transferor. Under Topic 860, the transferor may not maintain effective control over the transferred assets in order to qualify as a sale. This ASU eliminates the criteria under which the transferor must retain collateral sufficient to repurchase or redeem the collateral on substantially agreed upon terms as a method of maintaining effective control. This ASU is effective for both public and nonpublic entities for interim and annual reporting periods beginning on or after December 15, 2011, and requires prospective application to transactions or modifications of transactions which occur on or after the effective date. Early adoption is not permitted.

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

ASU 2011-04

This ASU amends FASB ASC Topic 820, *Fair Value Measurements*, to bring U.S. GAAP for fair value measurements in line with International Accounting Standards. The ASU clarifies existing guidance for items such as: the application of the highest and best use concept to nonfinancial assets and liabilities; the application of fair value measurement to financial instruments classified in a reporting entity's stockholders' equity; and, disclosure requirements regarding quantitative information about unobservable inputs used in the fair value measurements of Level 3 assets. The ASU also creates an exception to Topic 820 for entities which carry financial instruments within a portfolio or group, under which the entity is now permitted to base the price used for fair valuation upon a price that would be received to sell the net asset position or transfer a net liability position in an orderly transaction. The ASU also allows for the application of premiums and discounts in a fair value measurement if the financial instrument is categorized in Level 2 or 3 of the fair value hierarchy. Lastly, the ASU contains new disclosure requirements regarding fair value amounts categorized as Level 3 in the fair value hierarchy such as: disclosure of the valuation process used; effects of and relationships between unobservable inputs; usage of nonfinancial assets for purposes other than their highest and best use when that is the basis of the disclosed fair value; and, categorization by level of items disclosed at fair value, but not measured at fair value for financial statement purposes. For public entities, this ASU is effective for interim and annual periods beginning after December 15, 2011. For nonpublic entities, the ASU is effective for annual periods beginning after December 15, 2011. Early adoption is not permitted.

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

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NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

ASU 2011-05/ASU 2011-12

The provisions of this ASU amend FASB ASC Topic 220, *Comprehensive Income*, to facilitate the continued alignment of U.S. GAAP with International Accounting Standards. The ASU prohibits the presentation of the components of comprehensive income in the statement of stockholders' equity. Reporting entities are allowed to present either a statement of comprehensive income, which reports both net income and other comprehensive income, or separate, but consecutive, statements of net income and other comprehensive income. Under previous GAAP, all three presentations were acceptable. Regardless of the presentation selected, the reporting entity is required to present all reclassifications between other comprehensive and net income on the face of the new statement or statements. The provisions of this ASU are effective for fiscal years and interim periods beginning after December 15, 2011, for public entities. For nonpublic entities, the provisions are effective for fiscal years ending after December 15, 2012, and for interim and annual periods thereafter. As the two remaining options for presentation existed prior to the issuance of this ASU, early adoption is permitted.

In December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05.* In response to stakeholder concerns regarding the operational ramifications of the presentation of these reclassifications for current and previous years, the FASB has deferred the implementation date of this provision to allow time for further consideration. The requirement in ASU 2011-05, *Presentation of Comprehensive Income,* for the presentation of a combined statement of comprehensive income or separate, but consecutive, statements of net income and other comprehensive income is still effective for fiscal years and interim periods beginning after December 15, 2011, for public companies, and fiscal years ending after December 15, 2011, for nonpublic companies.

The Corporation does not expect the adoption of these standards to have a significant impact on its consolidated financial condition or results of operations.

ASU 2011-08

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

The Corporation is evaluating the impact of this standard on its consolidated financial statements.

ASU 2011-10

In December 2011, the FASB issued ASU 2011-10, *Derecognition of in Substance Real Estate a Scope Clarification.* This ASU clarifies previous guidance for situations in which a reporting entity would relinquish control of the assets of a subsidiary in order to satisfy the nonrecourse debt of the subsidiary. The ASU concludes that if control of the assets has been transferred to the lender, but not legal ownership of the assets; then the reporting entity must continue to include the assets of the subsidiary in its consolidated financial statements. The amendments in this ASU are effective for public

NOTE A SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

entities for annual and interim periods beginning on or after June 15, 2012. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2013. Early adoption is permitted.

The Corporation is evaluating the impact of this standard on its consolidated financial statements.

ASU 2011-11

In December 2011, the FASB issued ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities,* in an effort to improve comparability between U.S. GAAP and IFRS financial statements with regard to the presentation of offsetting assets and liabilities on the statement of financial position arising from financial and derivative instruments, and repurchase agreements. The ASU establishes additional disclosures presenting the gross amounts of recognized assets and liabilities, offsetting amounts, and the net balance reflected in the statement of financial position. Descriptive information regarding the nature and rights of the offset must also be disclosed.

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

NOTE B RESTRICTIONS ON CASH AND DUE FROM BANKS

In return for services obtained through correspondent banks, the Corporation is required to maintain non-interest bearing cash balances in those correspondent banks. At December 31, 2011 and 2010, compensating balances approximated $2,085,000 and $2,564,000, respectively. During 2011 and 2010, average compensating balances approximated $2,611,000 and $2,559,000, respectively. All compensating balances are met by vault cash.

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NOTE C SECURITIES

Amortized cost and fair value at December 31, 2011 and 2010, were as follows:

In thousands	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
December 31, 2011				
U.S. Government and agencies	**$ 39,237**	**$ 932**	**$**	**$ 40,169**
Mortgage-backed securities	**102,059**	**5,473**	**5**	**107,527**
State and municipal	**44,072**	**2,250**	**5**	**46,317**
Corporate bonds	**13,105**	**304**	**30**	**13,379**
CRA mutual fund	**1,044**	**37**		**1,081**
Stock in other banks	**627**	**127**		**754**
	$ 200,144	**$ 9,123**	**$ 40**	**$ 209,227**
December 31, 2010				
U.S. Government and agencies	$ 28,225	$ 297	$ 262	$ 28,260
Mortgage-backed securities	109,386	5,292	319	114,359
State and municipal	34,214	643	181	34,676
Corporate bonds	11,303	367	11	11,659
CRA mutual fund	1,032		2	1,030
Stock in other banks	627	119		746
	$ 184,787	$ 6,718	$ 775	$ 190,730
SECURITIES HELD TO MATURITY				
December 31, 2011				
U.S. Government and agencies	**$ 10,032**	**$ 648**	**$**	**$ 10,680**
December 31, 2010				
U.S. Government and agencies	$ 10,044	$ 627	$	$ 10,671

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NOTE C SECURITIES (Continued)

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

In thousands	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
SECURITIES AVAILABLE FOR SALE						
December 31, 2011						
Mortgage-backed securities	**$ 1,968**	**$ 5**	**$**	**$**	**$ 1,968**	**$ 5**
State and municipal	**1,251**	**5**			**1,251**	**5**
Corporate Bonds			**970**	**30**	**970**	**30**
	$ 3,219	**$ 10**	**$ 970**	**$ 30**	**$ 4,189**	**$ 40**
December 31, 2010						
U.S. Government and agencies	$ 10,585	$ 262	$	$	$ 10,585	$ 262
Mortgage-backed securities	21,071	319			21,071	319
State and municipal	11,680	181			11,680	181
Corporate Bonds	989	11			989	11
CRA mutual fund	1,030	2			1,030	2
	$ 45,355	$ 775	$	$	$ 45,355	$ 775

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

At December 31, 2011, one mortgage-backed security had an unrealized loss, and was in the continuous loss position for less than 12 months. This unrealized loss relates principally to changes in interest rates subsequent to the acquisition of the specific security. This security had an unrealized loss of less than 1% of amortized cost.

At December 31, 2011, four state and municipal securities had unrealized losses, and none of the municipal securities had been in a continuous loss position for 12 months or more. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of specific securities. None of the securities in this category had an unrealized loss that exceeded 2% of amortized cost.

At December 31, 2011, one corporate bond security had an unrealized loss. This security has 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 3% of amortized cost.

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.

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NOTE C SECURITIES (Continued)

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 an independent service provider to provide matrix pricing and uses the valuation of another provider to compare for reasonableness.

Management routinely sells securities from its available for sale portfolio in an effort to manage and allocate the portfolio. At December 31, 2011, management had not identified any securities with an unrealized loss that it intends to sell. In estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the securities, or (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) if management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management's intention and ability to hold the securities until recovery of unrealized losses.

The Corporation holds equity investments in the common stock of two bank holding companies headquartered and operating in Pennsylvania. Both holding companies continue to pay cash dividends, which was one of the driving forces in the original investment decision to purchase those stocks. However, 2009 market prices for these stocks were below the prices paid at the time of acquisition. A review of the factors contributing to the price decline led to a conclusion that the prices on these securities were not likely to recover in the near term and that they were other-than-temporarily impaired. A charge against current earnings of $522,000 was taken in the third quarter of 2009 to write down the value of these securities to their fair values.

Amortized cost and fair value at December 31, 2011, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	Available for Sale		Held to Maturity	
In thousands	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
1 year or less	**$ 6,582**	**$ 6,656**	**$**	**$**
Over 1 year through 5 years	**39,908**	**41,141**	**10,032**	**10,680**
Over 5 years through 10 years	**39,044**	**40,775**		
Over 10 years	**10,880**	**11,293**		
Mortgage-backed securities	**102,059**	**107,527**		
CRA mutual fund	**1,044**	**1,081**		
Stock in other banks	**627**	**754**		
	$ 200,144	**$ 209,227**	**$ 10,032**	**$ 10,680**

The Corporation realized gross gains of $1,000 during 2011, $128,000 during 2010, and $75,000 during 2009 and gross losses of $0 during 2011, $56,000 during 2010 and $58,000 during 2009 on sales of securities available for sale. State and municipal securities were sold at a loss in 2010 and 2009 in order to adjust the Corporation's interest rate sensitivity, reduce exposure to geographic locations, balance the mix with other investment types and to reduce risks related to insurance coverage.

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NOTE C SECURITIES (Continued)

At December 31, 2011 and 2010, securities with a carrying value of $124,069,000 and $99,197,000, respectively, were pledged as collateral as required by law on public and trust deposits, repurchase agreements and for other purposes.

NOTE D LOANS

The Bank grants commercial, residential and consumer loans to customers primarily within southcentral Pennsylvania and northern Maryland and the surrounding area. A large portion of the loan portfolio is secured by real estate. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy.

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Corporation's internal risk rating system as of December 31, 2011 and 2010:

In thousands	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2011					
Commercial and industrial	**$ 48,284**	**$ 4,596**	**$ 3,265**	**$**	**$ 56,145**
Commercial real estate	**200,834**	**19,872**	**15,311**		**236,017**
Commercial real estate construction	**7,400**	**12,743**	**2,614**		**22,757**
Residential mortgage	**304,627**	**4,261**	**2,378**		**311,266**
Home equity lines of credit	**50,083**	**2,364**	**85**		**52,532**
Consumer	**15,751**				**15,751**
Total	**$ 626,979**	**$ 43,836**	**$ 23,653**	**$**	**$ 694,468**
December 31, 2010					
Commercial and industrial	$ 43,448	$ 5,041	$ 4,187	$	$ 52,676
Commercial real estate	193,731	14,530	17,689		225,950
Commercial real estate construction	11,009	10,963	4,663		26,635
Residential mortgage	289,833	2,882	4,282		296,997
Home equity lines of credit	46,383	2,081	393		48,857
Consumer	14,176				14,176
Total	$ 598,580	$ 35,497	$ 31,214	$	$ 665,291

The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2011 and 2010:

	Impaired Loans with Allowance			Impaired Loans with No Allowance	
In thousands	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance
DECEMBER 31, 2011					
Commercial and industrial	**$ 1,967**	**$ 3,102**	**$ 1,085**	**$ 252**	**$ 1,367**
Commercial real estate	**273**	**273**	**43**	**6,339**	**7,136**
Commercial real estate construction				**2,614**	**7,192**
Residential mortgage	**88**	**88**	**53**	**1,313**	**1,638**
	$ 2,328	**$ 3,463**	**$ 1,181**	**$ 10,518**	**$ 17,333**

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NOTE D LOANS (Continued)

In thousands	Impaired Loans with Allowance Recorded Investment	Impaired Loans with Allowance Unpaid Principal Balance	Impaired Loans with Allowance Related Allowance	Impaired Loans with No Allowance Recorded Investment	Impaired Loans with No Allowance Unpaid Principal Balance
DECEMBER 31, 2010					
Commercial and industrial	$ 869	$ 1,869	$ 547	$ 68	$ 68
Commercial real estate	4,326	4,326	726	3,955	4,184
Commercial real estate construction	4,216	7,716	729	172	232
Residential mortgage	97	97	57	954	1,312
	$ 9,508	$ 14,008	$ 2,059	$ 5,149	$ 5,796

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

In thousands	Impaired Loans with Allowance Average Recorded Investment	Impaired Loans with Allowance Interest Income	Impaired Loans with No Allowance Average Recorded Investment	Impaired Loans with No Allowance Interest Income
DECEMBER 31, 2011				
Commercial and industrial	**$ 1,019**	**$**	**$ 349**	**$**
Commercial real estate	**2,324**		**4,946**	**44**
Commercial real estate construction			**3,463**	
Residential mortgage	**340**		**1,119**	
	$ 3,683	**$**	**$ 9,877**	**$ 44**

In thousands	Impaired Loans with Allowance Average Recorded Investment	Impaired Loans with Allowance Interest Income	Impaired Loans with No Allowance Average Recorded Investment	Impaired Loans with No Allowance Interest Income
DECEMBER 31, 2010				
Commercial and industrial	$ 904	$	$ 66	$
Commercial real estate	1,166	6	3,661	29
Commercial real estate construction	4,882	61	562	
Residential mortgage	24		1,339	4
	$ 6,976	$ 67	$ 5,628	$ 33

The following table presents nonaccrual loans by classes of the loan portfolio as of December 31, 2011 and 2010:

In thousands	2011	2010
Commercial and industrial	**$ 2,219**	$ 937
Commercial real estate	**6,612**	8,281
Commercial real estate construction	**2,614**	4,388
Residential mortgage	**1,401**	1,051
Total	**$ 12,846**	$ 14,657

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NOTE D LOANS (Continued)

The following table summarizes information in regards to troubled debt restructurings at December 31, 2011 and 2010:

In thousands	Pre-Modification Outstanding Recorded Investments	Post-Modification Outstanding Recorded Investments	Recorded Investment
December 31, 2011			
Commercial and industrial	**$ 490**	**$ 485**	**$ 234**
Commercial real estate	**$ 656**	**$ 656**	**$ 412**
Commercial real estate construction	**$ 1,548**	**$ 1,541**	**$ 850**
December 31, 2010			
Commercial and industrial	$ 490	$ 485	$ 439
Commercial real estate	$ 371	$ 373	$ 168
Commercial real estate construction	$ 1,548	$ 1,541	$ 1,536

All of the Corporation's troubled debt restructured loans are also nonaccrual impaired loans, which resulted in a specific allocation and, subsequently, a charge-off as appropriate. As of December 31, 2011, charge-offs associated with troubled debt restructured loans while under a forbearance agreement totaled $589,000. As of December 31, 2011, there were no defaulted troubled debt restructures as all troubled debt restructured loans were current with respect to their associated forbearance agreements. One forbearance agreement was negotiated during 2009 and modified during 2011, two were negotiated during 2010, while the other one was negotiated during 2011.

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

As a result of adopting the amendments in Accounting Standards Update No. 2011-02, the Corporation reassessed all troubled debt restructurings that occurred on or after January 1, 2011, for identification as troubled debt restructurings. The Corporation identified no loans for which the allowance for loan losses had previously been measured under a general allowance of credit losses methodology that are now considered troubled debt restructurings in accordance with Accounting Standards Update No. 2011-02.

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.

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NOTE D LOANS (Continued)

The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2011 and 2010:

In thousands	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
December 31, 2011							
Commercial and industrial	**$ 25**	**$ 14**	**$ 2,219**	**$ 2,258**	**$ 53,887**	**$ 56,145**	**$**
Commercial real estate	**329**	**4,184**	**6,663**	**11,176**	**224,841**	**236,017**	**51**
Commercial real estate construction			**2,614**	**2,614**	**20,143**	**22,757**	
Residential mortgage	**4,585**	**1,395**	**2,378**	**8,358**	**302,908**	**311,266**	**977**
Home equity lines of credit	**397**		**163**	**560**	**51,972**	**52,532**	**163**
Consumer	**20**	**8**		**28**	**15,723**	**15,751**	
Total	**$ 5,356**	**$ 5,601**	**$ 14,037**	**$ 24,994**	**$ 669,474**	**$ 694,468**	**$ 1,191**

In thousands	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Loans Receivable >90 Days and Accruing
December 31, 2010							
Commercial and industrial	$ 105	$	$ 937	$ 1,042	$ 51,634	$ 52,676	$
Commercial real estate	1,903	744	8,281	10,928	215,022	225,950	
Commercial real estate construction			4,388	4,388	22,247	26,635	
Residential mortgage	3,182	492	2,035	5,709	291,288	296,997	984
Home equity lines of credit	115	13	13	141	48,716	48,857	13
Consumer	16			16	14,160	14,176	
Total	$ 5,321	$ 1,249	$ 15,654	$ 22,224	$ 643,067	$ 665,291	$ 997

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NOTE D LOANS (Continued)

The following table summarizes the allowance for loan losses and recorded investment in financing receivables:

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
December 31, 2011								
Allowance for loan losses								
Beginning balance- January 1, 2011	**$ 2,074**	**$ 6,346**	**$ 1,154**	**$ 3,108**	**$ 341**	**$ 520**	**$ 1,709**	**$ 15,252**
Charge offs	**(1,861)**	**(1,308)**	**(1,242)**	**(750)**	**(52)**	**(30)**		**(5,243)**
Recoveries	**34**			**2**		**2**		**38**
Provisions	**2,335**	**969**	**636**	**1,264**	**218**	**(73)**	**86**	**5,435**
Ending balance- December 31, 2011	**$ 2,582**	**$ 6,007**	**$ 548**	**$ 3,624**	**$ 507**	**$ 419**	**$ 1,795**	**$ 15,482**
Ending balance: individually evaluated for impairment	**$ 1,085**	**$ 43**	**$**	**$ 53**	**$**	**$**	**$**	**$ 1,181**
Ending balance: collectively evaluated for impairment	**$ 1,497**	**$ 5,964**	**$ 548**	**$ 3,571**	**$ 507**	**$ 419**	**$ 1,795**	**$ 14,301**
Loans receivables								
Ending balance	**$ 56,145**	**$ 236,017**	**$ 22,757**	**$ 311,266**	**$ 52,532**	**$ 15,751**	**$**	**$ 694,468**
Ending balance: individually evaluated for impairment	**$ 2,219**	**$ 6,612**	**$ 2,614**	**$ 1,401**	**$**	**$**	**$**	**$ 12,846**
Ending balance: collectively evaluated for impairment	**$ 53,926**	**$ 229,405**	**$ 20,143**	**$ 309,865**	**$ 52,532**	**$ 15,751**	**$**	**$ 681,622**

In thousands	Commercial and Industrial	Commercial Real Estate	Commercial Real Estate Construction	Residential Mortgage	Home Equity Lines of Credit	Consumer	Unallocated	Total
December 31, 2010								
Allowance for loan losses								
Ending balance	$ 2,074	$ 6,346	$ 1,154	$ 3,108	$ 341	$ 520	$ 1,709	$ 15,252
Ending balance: individually evaluated for impairment	$ 547	$ 726	$ 729	$ 57	$	$	$	$ 2,059
Ending balance: collectively evaluated for impairment	$ 1,527	$ 5,620	$ 425	$ 3,051	$ 341	$ 520	$ 1,709	$ 13,193
Loans receivables								
Ending balance	$ 52,676	$ 225,950	$ 26,635	$ 296,997	$ 48,857	$ 14,176	$	$ 665,291
Ending balance: individually evaluated for impairment	$ 937	$ 8,281	$ 4,388	$ 1,051	$	$	$	$ 14,657
Ending balance: collectively evaluated for impairment	$ 51,739	$ 217,669	$ 22,247	$ 295,946	$ 48,857	$ 14,176	$	$ 650,634

Changes in the allowance for loan losses were as follows:

	Years Ended December 31,		
In thousands	**2011**	**2010**	**2009**
Balance, beginning	**$ 15,252**	$ 11,981	$ 7,393
Provision charged to operations	**5,435**	6,410	4,750
Recoveries on charged-off loans	**38**	42	186
Loans charged-off	**(5,243)**	(3,181)	(348)
Balance, ending	**$ 15,482**	$ 15,252	$ 11,981

If interest on all nonaccrual loans had been accrued at original contract rates, interest income would have increased by $652,000 in 2011, $464,000 in 2010, and $643,000 in 2009.

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NOTE D LOANS (Continued)

The following is a summary of information pertaining to impaired loans at December 31:

	Years Ended December 31,		
In thousands	**2011**	**2010**	**2009**
Average investment in impaired loans	**$ 13,560**	$ 12,604	$ 11,245
Interest income recognized on impaired loans	**$ 44**	$ 100	$ 218

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

NOTE E PREMISES AND EQUIPMENT

Premises and equipment at December 31 were as follows:

In thousands	**2011**	**2010**
Land	**$ 1,791**	$ 1,323
Buildings and improvements	**16,826**	16,014
Furniture and equipment	**11,737**	11,410
Assets in process	**267**	149
	30,621	28,896
Accumulated depreciation	**(16,138)**	(14,777)
	$ 14,483	$ 14,119

Depreciation expense was $1,578,000, $1,701,000 and $1,644,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

NOTE F INVESTMENTS IN LOW-INCOME HOUSING PARTNERSHIPS

ACNB Corporation is a limited partner in five partnerships, whose purpose is to develop, manage and operate residential low-income properties. At December 31, 2011 and 2010, the carrying value of these investments was approximately $3,774,000 and $4,124,000, respectively.

NOTE G DEPOSITS

Deposits were comprised of the following as of December 31:

In thousands	**2011**	**2010**
Non-interest bearing demand	**$ 112,247**	$ 103,464
Interest bearing demand	**114,112**	108,851
Savings	**266,560**	241,904
Time certificates of deposit less than $100,000	**208,894**	218,833
Time certificates of deposit greater than $100,000	**80,982**	73,474
	$ 782,795	$ 746,526

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NOTE G DEPOSITS (Continued)

Scheduled maturities of time certificates of deposit at December 31, 2011, were as follows:

Years Ending	In thousands
2012	**$ 172,158**
2013	**99,241**
2014	**10,711**
2015	**5,258**
2016	**2,508**
	$ 289,876

NOTE H LEASE COMMITMENTS

Certain branch offices and equipment are leased under agreements which expire at varying dates through 2021. Most leases contain renewal provisions at the Corporation's option. The total rental expense for all operating leases was $405,000, $462,000 and $489,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

The following is a schedule by year of future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of December 31:

Years Ending	In thousands
2012	$ 385
2013	380
2014	355
2015	322
2016	226
Later years	354
	$ 2,022

ACNB leases space at several of its owned offices to other unrelated organizations under agreements that expire at varying dates from 2012 to 2014. Most leases contain renewal provisions at the option of the lessee. Total rental income for these properties was $130,000, $123,000 and $122,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

NOTE I BORROWINGS

Short-term borrowings and weighted-average interest rates at December 31 are as follows:

	2011		**2010**	
Dollars in thousands	**Amount**	**Rate**	**Amount**	**Rate**
Treasury tax and loan note	**$**	**0.00%**	$ 1,823	0.00%
Securities sold under repurchase agreements	**45,962**	**0.20%**	37,263	0.24%
	$ 45,962	**0.20%**	$ 39,086	0.23%

Under an agreement with the FHLB, the Bank has short-term borrowing capacity included in the maximum borrowing capacity. All FHLB advances are collateralized by a security agreement covering qualifying loans and unpledged U.S. Treasury, agency and mortgage-backed securities. In addition, all

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NOTE I BORROWINGS (Continued)

FHLB advances are secured by the FHLB capital stock owned by the Bank having a par value of $6,848,000 at December 31, 2011. The Corporation also has lines of credit that total $15,000,000 with correspondent banks for overnight federal funds borrowings.

The Corporation offers a short-term investment program for corporate customers for secured investing. This program consists of overnight and short-term repurchase agreements that are secured by designated investment securities owned by the Corporation. The investment securities are under the control of the Corporation.

A summary of long-term debt as of December 31 is as follows:

	2011		2010	
Dollars in thousands	**Amount**	**Rate**	**Amount**	**Rate**
FHLB fixed-rate advances maturing:				
2011	$	%	$ 10,000	2.92%
2012	**11,000**	**4.14%**	11,000	4.14%
2013	**14,000**	**2.55%**	14,000	2.55%
2014	**11,000**	**3.31%**	11,000	3.31%
2015	**12,000**	**3.87%**	12,000	3.87%
2016	**5,000**	**4.52%**	5,000	4.52%
2017	**4,000**	**4.86%**	4,000	4.86%
2018	**2,000**	**5.11%**	2,000	5.11%
FHLB convertible advance maturing 2012	**10,000**	**4.27%**	10,000	4.27%
Loan payable to local bank	**2,191**	**6.35%**	2,499	6.50%
	$ 71,191	**3.83%**	$ 81,499	3.74%

The FHLB advances are collateralized by the assets defined in security agreement and FHLB capital stock described previously. The Corporation can borrow a maximum of $297,282,000 from the FHLB, of which $228,282,000 was available at December 31, 2011. The FHLB has the option to convert the $10,000,000 convertible advance, but not before three-month LIBOR reaches 8%. Upon the FHLB's conversion, the Bank has the option to repay the advance in full.

The loan payable to a local bank is payable in monthly installments of $29,472 and matures in April 2016. The loan is unsecured.

NOTE J REGULATORY RESTRICTIONS ON DIVIDENDS

Dividend payments by the Bank to the Corporation are subject to the Pennsylvania Banking Code, the Federal Deposit Insurance Act, and the regulations of the FDIC. Under the Banking Code, no dividends may be paid except from "accumulated net earnings" (generally, retained earnings). The Federal Reserve Board and the FDIC have formal and informal policies which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings, with some exceptions. As of December 31, 2011, $8,388,000 of undistributed earnings of the Bank, included in consolidated retained earnings, was available for distribution to the Corporation as dividends without prior regulatory approval. Additionally, dividends paid by the Bank to the Corporation would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

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NOTE K INCOME TAXES

The components of income tax expense (benefit) for the years ended December 31, 2011, 2010 and 2009, are as follows:

In thousands	2011	2010	2009
Federal:			
Current	**$ 1,816**	$ 722	$ 2,942
Deferred	**279**	1,296	(1,647)
	2,095	2,018	1,295
State:			
Current	**59**	39	62
	$ 2,154	$ 2,057	$ 1,357

Reconciliations of the statutory federal income tax at a rate of 34% to the income tax expense reported in the consolidated statements of income for the years ended December 31, 2011, 2010 and 2009, are as follows:

	Percentage of Income before Income Taxes		
	2011	2010	2009
Federal income tax at statutory rate	**34.0%**	34.0%	34.0%
State income taxes, net of federal benefit	**0.4%**	0.4%	0.5%
Tax-exempt income	**(6.0)%**	(5.8)%	(6.9)%
Earnings on investment in life insurance	**(3.1)%**	(3.5)%	(4.0)%
Rehabilitation and low-income housing credits	**(5.2)%**	(5.5)%	(7.9)%
Other	**0.1%**	0.1%	0.1%
	20.2%	19.7%	15.8%

The provision for federal income taxes includes $0, $24,000 and $6,000 of income taxes related to net gains on sales of securities in 2011, 2010 and 2009, respectively. Rehabilitation and low-income housing income tax credits were $556,000, $578,000, and $679,000 during 2011, 2010 and 2009, respectively. Projected credits are $556,000 in 2012, $405,000 in 2013, and $372,000 thereafter.

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NOTE K INCOME TAXES (Continued)

Components of deferred tax assets and liabilities at December 31 were as follows:

In thousands	2011	2010
Deferred tax assets:		
Allowance for loan losses	**$ 5,264**	$ 5,152
Accrued deferred compensation	**664**	672
Pension	**2,751**	1,412
Deferred loan fees	**35**	70
Other than temporary impairment	**178**	178
Low income housing tax credit carryforward	**447**	385
Non-accrual interest	**230**	224
Director deferred liability	**300**	221
Other	**382**	172
	10,251	8,486
Deferred tax liabilities:		
Available for sale securities	**3,088**	2,021
Prepaid pension benefit cost	**4,268**	3,398
Prepaid expenses	**281**	316
Accumulated depreciation	**540**	574
Goodwill/intangibles	**627**	723
	8,804	7,032
Net Deferred Tax Asset	**$ 1,447**	$ 1,454

The Corporation has a federal tax credit carryforward related to low income housing credits that expires in 2030.

The Corporation did not have any uncertain tax positions at December 31, 2011 and 2010. The Corporation's policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense in the Consolidated Statements of Income.

Years that remain open for potential review by the Internal Revenue Service are 2008 through 2010.

NOTE L 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.

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NOTE L FAIR VALUE MEASUREMENTS (Continued)

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.

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NOTE L FAIR VALUE MEASUREMENTS (Continued)

For assets measured at fair value, the fair value measurements by level within the fair value hierarchy, and the basis on measurement used at December 31, 2011 and 2010, are as follows:

		Fair Value Measurements at December 31, 2011			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		**$ 40,169**	**$**	**$ 40,169**	**$**
Mortgage-backed securities		**107,527**		**107,527**	
State and municipal		**46,317**		**46,317**	
Corporate bonds		**13,379**		**13,379**	
CRA mutual fund		**1,081**	**1,081**		
Stock in other banks		**754**	**754**		
Total securities available for sale	**Recurring**	**$ 209,227**	**$ 1,835**	**$ 207,392**	**$**
Impaired loans	**Non-recurring**	**8,075**			**8,075**
Foreclosed assets held for resale	**Non-recurring**	**1,176**			**1,176**

		Fair Value Measurements at December 31, 2010			
In thousands	**Basis**	**Total**	**Level 1**	**Level 2**	**Level 3**
U.S. Government and agencies		$ 28,260	$	$ 28,260	$
Mortgage-backed securities		114,359		114,359	
State and municipal		34,676		34,676	
Corporate bonds		11,659		11,659	
CRA mutual fund		1,030	1,030		
Stock in other banks		746	746		
Total securities available for sale	Recurring	$ 190,730	$ 1,776	$ 188,954	$
Impaired loans	Non-recurring	8,504			8,504
Foreclosed assets held for resale	Non-recurring	518			518

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 the Corporation's financial instruments at December 31, 2011 and 2010:

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.

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 securities 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.

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NOTE L FAIR VALUE MEASUREMENTS (Continued)

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

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

Loans (Carried at Cost)

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

Impaired Loans (Generally Carried at Fair Value)

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

Foreclosed Assets Held for Resale

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 on appraisals that consider the sales prices of similar properties in the proximate vicinity.

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 amount of accrued interest receivable and accrued interest payable approximates its 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)

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,

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NOTE L FAIR VALUE MEASUREMENTS (Continued)

terms and remaining maturity. These 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

Fair values for the Corporation's off-balance sheet financial instruments (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.

Estimated fair values of financial instruments at December 31 were as follows:

	2011		2010	
In thousands	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:				
Cash and due from banks	**$ 14,423**	**$ 14,423**	$ 14,091	$ 14,091
Interest bearing deposits in banks	**8,200**	**8,200**	10,082	10,082
Investment securities				
Available for sale	**209,227**	**209,227**	190,730	190,730
Held to maturity	**10,032**	**10,680**	10,044	10,671
Loans held for sale	**337**	**337**	3,068	3,068
Loans, less allowance for loan losses	**678,986**	**710,671**	650,039	665,253
Accrued interest receivable	**3,674**	**3,674**	3,417	3,417
Restricted investment in bank stocks	**7,146**	**7,146**	8,420	8,420
Financial liabilities:				
Deposits	**782,795**	**784,784**	746,526	750,068
Short-term borrowings	**45,962**	**45,962**	39,086	39,086
Long-term borrowings	**71,191**	**75,792**	81,499	85,772
Accrued interest payable	**1,429**	**1,429**	1,667	1,667
Off-balance sheet financial instruments				

NOTE M RETIREMENT PLANS

The Corporation's banking subsidiary has a non-contributory, defined benefit pension plan. Retirement benefits are a function of both years of service and compensation. The funding policy is to contribute annually the amount that is sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act.

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NOTE M RETIREMENT PLANS (Continued)

A measurement date of December 31 has been used for the fiscal year ending December 31, 2011 and 2010.

In thousands	2011	2010
Change in benefit obligation:		
Benefit obligation at beginning of year	**$ 17,919**	$ 18,283
Service cost	**570**	458
Interest cost	**962**	1,074
Actuarial (gain) loss	**2,303**	(1,153)
Benefits paid	**(765)**	(743)
Benefit obligation at end of year	**20,989**	17,919
Change in plan assets:		
Fair value of plan assets at beginning of year	**23,760**	15,618
Actual return on plan assets	**1**	2,335
Employer contribution	**2,455**	6,550
Benefits paid	**(765)**	(743)
Fair value of plan assets at end of year	**25,451**	23,760
Funded Status, included in other assets	**$ 4,462**	$ 5,841
Amounts recognized in accumulated other comprehensive income:		
Total net actuarial loss	**$ 7,937**	$ 3,947
Transition obligation	**10**	22
Prior service cost	**144**	184
Total included in accumulated other comprehensive income (pretax)	**$ 8,091**	$ 4,153

The estimated costs that will be amortized from accumulated other comprehensive income into net periodic pension cost during the next fiscal year are as follows:

In thousands	
Net loss	$ 611
Prior service cost	40
Net transition liability	10
	$ 661

The accumulated benefit obligation totaled $20,658,000 and $17,755,000 at December 31, 2011 and 2010, respectively.

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NOTE M RETIREMENT PLANS (Continued)

The components of net periodic benefit costs (income) related to the non-contributory, defined benefit pension plan for the years ended December 31 are as follows:

In thousands	2011	2010	2009
Components of net periodic benefit cost (income):			
Service cost	**$ 570**	$ 458	$ 561
Interest cost	**962**	1,074	989
Expected return on plan assets	**(1,829)**	(1,216)	(964)
Recognized net actuarial loss	**140**	436	579
Amortization of transition liability	**12**	12	12
Amortization of prior service cost	**40**	39	39
Net Periodic Benefit Cost (Income)	**$ (105)**	$ 803	$ 1,216

For the years ended December 31, 2011, 2010 and 2009, the assumptions used to determine the benefit obligation are as follows:

	2011	2010	2009
Discount rate	**4.50%**	5.50%	6.00%
Rate of compensation increase	**4.00%**	3.58%	3.55%

For the years ended December 31, 2011, 2010 and 2009, the assumptions used to determine the net periodic benefit cost (income) are as follows:

	2011	2010	2009
Discount rate	**5.50%**	6.00%	6.00%
Expected long-term rate of return on plan assets	**7.50%**	7.75%	7.75%
Rate of compensation increase	**3.58%**	3.55%	3.58%

The Corporation's pension plan weighted-average assets' allocations at December 31, 2011 and 2010, are as follows:

	2011	2010
Equity securities	**44%**	43%
Debt securities	**42%**	35%
Short-term fixed income	**8%**	18%
Real estate	**6%**	4%
	100%	100%

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NOTE M RETIREMENT PLANS (Continued)

The Corporation's overall investment strategy is to achieve a mix of investments to meet the long-term rate of return assumption and near-term pension obligations with a diversification of assets 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 and plan expense, and any applicable regulatory requirements. The weighted-average assets' allocation in the above table represents the Corporation's conclusion on the appropriate mix of investments. The specific investment vehicles are institutional separate accounts from a variety of fund managers which are regularly reviewed by the Corporation for acceptable performance.

Equity securities included Corporation common stock in amounts of $786,000, 3% of total plan assets, and $849,000, 4% of total plan assets, at December 31, 2011 and 2010, respectively.

Fair value measurements at December 31, 2011, are as follows:

In thousands	**Total**	**Level 1**	**Level 2**	**Level 3**
Equity securities	**$ 11,814**	**$ 786**	**$ 11,028**	**$**
Debt securities	**12,316**		**12,316**	
Real estate	**1,320**		**1,320**	

Fair value measurements at December 31, 2010, are as follows:

In thousands	**Total**	**Level 1**	**Level 2**	**Level 3**
Equity securities	$ 15,012	$ 849	$ 14,163	$
Debt securities	8,217		8,217	
Real estate	531			531

The following table summarizes the effect the Level 3 investments had on the plan's current year financial activity:

In thousands	**Real Estate**
Balance January 1, 2011	**$ 531**
Total gains	**15**
Transfer out of Level 3	**(546)**
Balance December 31, 2011	**$**
Balance January 1, 2010	$ 458
Total gains	73
Balance December 31, 2010	$ 531

It has not yet been determined the amount the Bank plans on contributing to the Plan in 2012. The Corporation reduced the benefit formula for the defined benefit pension plan effective January 1, 2010, in order to manage total benefit costs. The new formula is the earned benefit as of December 31, 2009, plus 0.75% of a participant's average monthly pay multiplied by years of benefit service earned on and after January 1, 2010, but not more than 25 years. The benefit percentage factor and maximum years of service eligible were both reduced.

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NOTE M RETIREMENT PLANS (Continued)

Based on current data and assumptions, the following benefit payments, which reflect expected future service, as appropriate, are:

Years Ending	In thousands
2012	$ 880
2013	900
2014	970
2015	1,100
2016	1,020
2017-2021	6,620

The Corporation's banking subsidiary maintains a 401(k) plan for the benefit of eligible employees. Employees may contribute up to 100% of their compensation subject to certain limits based on federal tax laws. The Bank makes matching contributions up to 100% of the first 4% of an employee's compensation contributed to the plan. Matching contributions vest immediately to the employee. Bank contributions to and expenses for the plan were $461,000, $432,000 and $435,000 for 2011, 2010 and 2009, respectively.

The Corporation's banking subsidiary maintains non-qualified compensation plans for selected senior officers. The estimated present value of future benefits is accrued over the period from the effective date of the agreements until the expected retirement dates of the individuals. The balance accrued for these plans included in other liabilities as of December 31, 2011 and 2010, totaled $1,372,000 and $1,326,000, respectively. The annual expense included in salaries and benefits expense totaled $143,000, $152,000 and $146,000 during the years ended December 31, 2011, 2010 and 2009, respectively. To fund the benefits under these plans, the Bank is the owner of single premium life insurance policies on participants in the non-qualified retirement plans. At December 31, 2011 and 2010, the cash surrender value of these policies was $4,365,000 and $4,226,000, respectively.

NOTE N REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth below) of Tier 1 capital to average assets and of Tier 1 and total capital (as defined in the regulations) to risk weighted assets. Management believes, as of December 31, 2011, that the Corporation and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2011, the most recent notification from the federal banking regulators categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

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NOTE N REGULATORY MATTERS (Continued)

On May 5, 2009, stockholders approved and ratified the ACNB Corporation 2009 Restricted Stock Plan, which awards shall not exceed, in the aggregate, 200,000 shares of Common Stock. As of December 31, 2011, no shares have been issued under the plan. In January 2011, the Corporation offered stockholders the opportunity to participate in the ACNB Corporation Dividend Reinvestment and Stock Purchase Plan. The plan allows registered stockholders who have a minimal number of shares to participate and also provides for voluntary cash purchases of ACNB Corporation common stock. As of December 31, 2011, 17,466 shares of common stock were issued within the plan.

The actual and required capital amounts and ratios were as follows:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
Dollars in thousands	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
CORPORATION						
As of December 31, 2011						
Tier 1 leverage ratio (to average assets)	**$ 87,546**	**8.71%**	**≥40,215**	**≥4.0%**	**N/A**	**N/A**
Tier 1 risk-based capital ratio (to risk-weighted assets)	**87,546**	**12.75**	**≥27,464**	**≥4.0**	**N/A**	**N/A**
Total risk-based capital ratio (to risk- weighted assets)	**96,252**	**14.02**	**≥54,928**	**≥8.0**	**N/A**	**N/A**
As of December 31, 2010						
Tier 1 leverage ratio (to average assets)	$ 82,991	8.54%	≥38,851	≥4.0%	N/A	N/A
Tier 1 risk-based capital ratio (to risk-weighted assets)	82,991	12.44	≥26,678	≥4.0	N/A	N/A
Total risk-based capital ratio (to risk- weighted assets)	91,450	13.71	≥53,356	≥8.0	N/A	N/A
BANK						
As of December 31, 2011						
Tier 1 leverage ratio (to average assets)	**$ 82,703**	**8.24%**	**≥40,144**	**≥4.0%**	**≥50,180**	**≥5.0%**
Tier 1 risk-based capital ratio (to risk-weighted assets)	**82,703**	**12.07**	**≥27,415**	**≥4.0**	**≥41,123**	**≥6.0**
Total risk-based capital ratio (to risk- weighted assets)	**91,307**	**13.32**	**≥54,830**	**≥8.0**	**≥68,538**	**≥10.0**
As of December 31, 2010						
Tier 1 leverage ratio (to average assets)	$ 79,579	8.24%	≥38,629	≥4.0%	≥48,286	≥5.0%
Tier 1 risk-based capital ratio (to risk-weighted assets)	79,579	11.99	≥26,557	≥4.0	≥39,835	≥6.0
Total risk-based capital ratio (to risk- weighted assets)	87,965	13.25	≥53,114	≥8.0	≥66,392	≥10.0

NOTE O FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Corporation is a 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 consist primarily of commitments to extend credit (typically mortgages and commercial loans) and, to a lesser

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NOTE O FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK (Continued)

extent, standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments. The Corporation does not anticipate any material losses from these commitments.

Commitments to extend credit, including commitments to grant loans and unfunded commitments under lines of credit, are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extensions of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property and equipment and income-producing commercial properties. On loans secured by real estate, the Corporation generally requires loan to value ratios of no greater than 80%.

Standby letters of credit are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements and similar transactions. The terms of the letters of credit vary and may have renewal features. The credit risk involved in using letters of credit is essentially the same as that involved in extending loans to customers. The Corporation holds collateral supporting those commitments for which collateral is deemed necessary. Management believes that the proceeds obtained through a liquidation of such collateral would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of December 31, 2011 and 2010, for guarantees under standby letters of credit issued is not material.

The Corporation has not been required to perform on any financial guarantees, and has not incurred any losses on its commitments, during the past two years.

A summary of the Corporation's commitments at December 31 were as follows:

In thousands	**2011**	**2010**
Commitments to extend credit	**$ 129,586**	$ 120,179
Standby letters of credit	**6,230**	5,897

NOTE P CONTINGENCIES

The Corporation is subject to claims and lawsuits which arise primarily in the ordinary course of business. Based on information presently available and advice received from legal counsel representing the Corporation in connection with any such claims and lawsuits, it is the opinion of management that the disposition or ultimate determination of any such claims and lawsuits will not have a material adverse effect on the consolidated financial position, consolidated results of operations or liquidity of the Corporation.

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NOTE Q ACNB CORPORATION (PARENT COMPANY ONLY) FINANCIAL INFORMATION

STATEMENTS OF CONDITION

	December 31,	
In thousands	**2011**	**2010**
ASSETS		
Cash	**$ 266**	$ 183
Investment in banking subsidiary	**83,274**	80,682
Investment in other subsidiaries	**9,993**	9,566
Investments in low-income housing partnerships	**3,774**	4,124
Securities and other assets	**1,634**	1,324
Receivable from banking subsidiary	**724**	374
Total Assets	**$ 99,665**	$ 96,253
LIABILITIES AND STOCKHOLDERS' EQUITY		
Long-term debt	**$ 2,191**	$ 2,499
Stockholders' equity	**97,474**	93,754
Total Liabilities and Stockholders' Equity	**$ 99,665**	$ 96,253

STATEMENTS OF INCOME

	Years Ended December 31,		
In thousands	**2011**	**2010**	**2009**
Dividends from banking subsidiary	**$ 4,689**	$ 4,506	$ 4,512
Other income	**47**	288	293
	4,736	4,794	4,805
Impairment charges on equity securities			522
Expenses	**494**	445	111
	4,242	4,349	4,172
Income tax benefit	**709**	633	966
	4,951	4,982	5,138
Equity in undistributed earnings of subsidiaries	**3,551**	3,437	2,081
Net Income	**$ 8,502**	$ 8,419	$ 7,219

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NOTE Q ACNB CORPORATION (PARENT COMPANY ONLY) FINANCIAL INFORMATION (Continued)

STATEMENTS OF CASH FLOWS

In thousands	Years Ended December 31, 2011	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	**$ 8,502**	$ 8,419	$ 7,219
Equity in undistributed earnings of subsidiaries	**(3,551)**	(3,437)	(2,081)
(Increase) Decrease in receivable from banking subsidiary	**(350)**	21	294
Impairment charges on equity securities			522
Other	**45**	257	92
Net Cash Provided by Operating Activities	**4,646**	5,260	6,046
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment in insurance agency subsidiary			
Net Cash Used in Investing Activities			
CASH FLOWS USED IN FINANCING ACTIVITIES			
Repayments on long-term debt	**(308)**	(795)	(1,657)
Purchase of treasury stock			(286)
Proceeds from issuance of common stock	**257**		
Dividends paid	**(4,512)**	(4,506)	(4,512)
Net Cash Used in Financing Activities	**(4,563)**	(5,301)	(6,455)
Net Increase (Decrease) in Cash and Cash Equivalents	**83**	(41)	(409)
CASH AND CASH EQUIVALENTS BEGINNING	**183**	224	633
CASH AND CASH EQUIVALENTS ENDING	**$ 266**	$ 183	$ 224

NOTE R ACQUISITIONS

In 2008, RIG acquired a book of business with an aggregate purchase price of $1,165,000, of which, all was classified as an intangible asset. Also, on December 31, 2008, RIG acquired Marks Insurance & Associates, Inc. with an aggregate purchase price of $1,853,000, of which $1,300,000 was recorded as an intangible asset and $553,000 was recorded as goodwill. The contingent consideration for both 2008 purchases was calculated based on 2011 results of operations. The contingent consideration of $338,000 is included in goodwill and the other liabilities section of the consolidated statement of condition and was subsequently paid on January 13, 2012.

In 2010, RIG acquired an additional book of business with an aggregate purchase price of $31,000, of which, all was classified as an intangible asset.

The carrying value and accumulated amortization of the intangible assets (customer lists) as of December 31, 2011 and 2010, are as follows:

In thousands	2011 Gross Carrying Amount	2011 Accumulated Amortization	2010 Gross Carrying Amount	2010 Accumulated Amortization
Amortized intangible assets	**$ 6,417**	**$ 3,368**	$ 6,415	$ 2,727

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NOTE R ACQUISITIONS (Continued)

Amortization of the intangible assets for the five years subsequent to December 31, 2011, is expected to be as follows:

Years Ending	In thousands
2012	$ 641
2013	641
2014	641
2015	316
2016	314

NOTE S SEGMENT AND RELATED INFORMATION

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

Segment information for 2011, 2010 and 2009 is as follows:

In thousands	Banking	Insurance	Total
2011			
Net interest income and other income from external customers	**$ 41,463**	**$ 4,644**	**$ 46,107**
Income before income taxes	**9,951**	**705**	**10,656**
Total assets	**992,252**	**12,571**	**1,004,823**
Capital expenditures	**1,938**	**4**	**1,942**
2010			
Net interest income and other income from external customers	$ 42,503	$ 4,686	$ 47,189
Income before income taxes	10,005	471	10,476
Total assets	956,662	12,005	968,667
Capital expenditures	1,068	21	1,089
2009			
Net interest income and other income from external customers	$ 38,607	$ 5,348	$ 43,955
Income before income taxes	7,801	775	8,576
Total assets	949,130	12,774	961,904
Capital expenditures	1,902	49	1,951

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QUARTERLY RESULTS OF OPERATIONS

Selected quarterly information for the years ended December 31, 2011 and 2010, is as follows:

In thousands, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2011				
Interest income	**$ 10,480**	**$ 10,488**	**$ 10,421**	**$ 10,443**
Interest expense	**1,916**	**1,894**	**1,863**	**1,789**
Net interest income	**8,564**	**8,594**	**8,558**	**8,654**
Provision for loan losses	**1,100**	**1,310**	**1,200**	**1,825**
Net interest income after provision for loan losses	**7,464**	**7,284**	**7,358**	**6,829**
Net gains on sales of securities			**1**	
Other income	**2,957**	**3,007**	**2,881**	**2,891**
Other expenses and provision for income taxes	**7,961**	**8,185**	**8,060**	**7,964**
Net income	**$ 2,460**	**$ 2,106**	**$ 2,180**	**$ 1,756**
Basic earnings per share	**$ 0.41**	**$ 0.36**	**$ 0.37**	**$ 0.29**
Dividends per share	**$ 0.19**	**$ 0.19**	**$ 0.19**	**$ 0.19**
2010				
Interest income	$ 11,125	$ 11,690	$ 11,100	$ 10,725
Interest expense	2,555	2,482	2,388	2,198
Net interest income	8,570	9,208	8,712	8,527
Provision for loan losses	859	2,351	1,400	1,800
Net interest income after provision for loan losses	7,711	6,857	7,312	6,727
Net gains (losses) on sales of securities	26	(1)	47	
Other income	2,842	3,161	2,869	3,228
Other expenses and provision for income taxes	8,157	7,952	7,924	8,327
Net income	$ 2,422	$ 2,065	$ 2,304	$ 1,628
Basic earnings per share	$ 0.41	$ 0.35	$ 0.39	$ 0.27
Dividends per share	$ 0.19	$ 0.19	$ 0.19	$ 0.19

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

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 our 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 our periodic SEC filings.

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Based on our evaluation of the effectiveness of the design and operation of the disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that the Corporation's disclosure controls and procedures were effective as of December 31, 2011. The Corporation believes that the accompanying consolidated financial statements fairly present the financial condition and results of operations for the fiscal years presented in this report on Form 10-K.

CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

We have made no changes in the Corporation's internal controls over financial reporting in connection with our fourth quarter evaluation that would materially affect, or are reasonably likely to materially affect, our internal controls over financial reporting

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

ACNB Corporation (ACNB) is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles, and as such, include some amounts that are based on management's best estimates and judgments.

ACNB's management is responsible for establishing and maintaining effective internal control over financial reporting. The system of internal control over financial reporting, as it relates to the consolidated financial statements, is evaluated for effectiveness by management and tested for reliability through a program of internal audits and management testing and review. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

The Board of Directors of ACNB, through its Audit Committee, meets regularly with management, internal auditors, and the independent registered public accounting firm. The Audit Committee provides oversight to ACNB by reviewing audit plans and results, and evaluates management's actions for internal control, accounting and financial reporting matters. The internal auditors and independent registered public accounting firm have direct and confidential access to the Audit Committee to discuss the results of their examinations.

Management assessed the effectiveness of ACNB's internal control over financial reporting as of December 31, 2011. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*. Based on our assessment, management concluded that as of December 31, 2011, ACNB's internal control over financial reporting is effective and meets the criteria of the *Internal Control Integrated Framework*.

ACNB's independent registered public accounting firm, ParenteBeard LLC, has issued an attestation report on ACNB's internal control over financial reporting. This report appears on pages 103 and 104.

/s/ THOMAS A. RITTER	/s/ DAVID W. CATHELL
Thomas A. Ritter President & Chief Executive Officer	David W. Cathell Executive Vice President, Treasurer & Chief Financial Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited ACNB Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). ACNB Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on ACNB Corporation and Subsidiaries' internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A corporation's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A corporation's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the corporation; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the corporation are being made only in accordance with authorizations of management and directors of the corporation; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the corporation's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, ACNB Corporation and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

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We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of condition and the related statements of income, changes in stockholders' equity, and cash flows of ACNB Corporation and Subsidiaries, and our report dated March 12, 2012 expressed an unqualified opinion.

ParenteBeard LLC
Harrisburg, Pennsylvania
March 12, 2012

ITEM 9B OTHER INFORMATION

None.

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PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item 10, relating to directors, executive officers, and control persons, is set forth in sections "Information as to Nominees and Directors", "Executive Officers of ACNB Corporation", "Meetings and Committees of the Board of Directors", "Audit Committee Report" and "Section 16(a) Beneficial Ownership Reporting Compliance" of ACNB Corporation's definitive Proxy Statement to be used in connection with the 2012 Annual Meeting of Shareholders, which pages are incorporated herein by reference.

The Corporation has adopted a Code of Ethics that applies to directors, officers and employees of the Corporation and its subsidiaries. A copy of the Code of Ethics is included as an exhibit to the Form 8-K filed by the Corporation on March 19, 2010. A request for the Corporation's Code of Ethics can be made either in writing to Lynda L. Glass, Executive Vice President, Secretary & Chief Governance Officer, ACNB Corporation, 16 Lincoln Square, P.O. Box 3129, Gettysburg, Pennsylvania 17325 or by telephone at 717-334-3161.

There have been no material changes to the procedures by which stockholders may recommend nominees to the Corporation's Board of Directors.

ITEM 11 EXECUTIVE COMPENSATION

Incorporated by reference in response to this Item 11 is the information appearing under the headings "Compensation and Plan Information", "Potential Payments Upon Termination or Change In Control", "Compensation Committee Report" and "Compensation Committee Interlocks and Insider Participation" in ACNB Corporation's 2012 definitive Proxy Statement.

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

Incorporated by reference in response to this Item 12 is the information appearing under the heading "Share Ownership" in ACNB Corporation's 2012 definitive Proxy Statement.

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Incorporated by reference in response to this Item 13 is the information appearing under the headings "Transactions with Directors and Executive Officers" and "Governance of the Corporation" in ACNB Corporation's 2012 definitive Proxy Statement.

ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES

Incorporated by reference in response to this Item 14 is the information appearing under the heading "Independent Auditors" in ACNB Corporation's 2012 definitive Proxy Statement.

PART IV

ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)

1. FINANCIAL STATEMENTS

The following financial statements are filed as part of this report:

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Condition

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2.
FINANCIAL STATEMENT SCHEDULES

Financial statement schedules are omitted because the required information is either not applicable, not required, or is shown in the respective consolidated financial statements or in the notes thereto.

(b)
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 March 22, 2010.)
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, Thomas A. Ritter and Lynda L. Glass. (Incorporated by reference to Exhibit 10.2 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Commission on March 13, 2009.)
Exhibit 10.3	Executive Supplemental Life Insurance Plan Applicable to Ronald L. Hankey, Thomas A. Ritter, David W. Cathell and Lynda L. Glass. (Incorporated by reference to Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2008, filed with the Commission on November 7, 2008.)
Exhibit 10.4	Director Supplemental Life Insurance Plan Applicable to Frank Elsner III, James J. Lott, Robert W. Miller, Daniel W. Potts, Marian B. Schultz, David L. Sites, Alan J. Stock, Jennifer L. Weaver, Harry L. Wheeler and James E. Williams. (Incorporated by reference to Exhibit 10.5 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004, filed with the Commission on March 15, 2005.)
Exhibit 10.5	Amended and Restated Director Deferred Fee Plan Applicable to Frank Elsner III, James J. Lott, Robert W. Miller, Marian B. Schultz, Alan J. Stock, Jennifer L. Weaver, Harry L. Wheeler and James E. Williams. (Incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K, filed with the Commission on January 6, 2012.)
Exhibit 10.6	ACNB Bank Salary Savings Plan. (Incorporated by reference to Exhibit 10.6 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Commission on March 12, 2010.)

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Exhibit 10.7	Group Pension Plan for Employees of ACNB Bank. (Incorporated by reference to Exhibit 10.7 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 10.8	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 11	Statement re Computation of Earnings. (Incorporated by reference to page 69 of this Form 10-K.)
Exhibit 14	Code of Ethics. (Incorporated by reference to Exhibit 14 of the Registrant's Current Report on Form 8-K, filed with the Commission on March 19, 2010.)
Exhibit 21	Subsidiaries of the Registrant.
Exhibit 23	Consent of Independent Registered Public Accounting Firm
Exhibit 31.1	Chief Executive Officer Certification of Annual Report on Form 10-K.
Exhibit 31.2	Chief Financial Officer Certification of Annual Report on Form 10-K.
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.

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SIGNATURES

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

ACNB CORPORATION (Registrant) March 12, 2012

Date

By: /s/ THOMAS A. RITTER

Thomas A. Ritter
President & Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed on March 12, 2012, by the following persons in the capacities indicated.

/s/ DAVID W. CATHELL

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

/s/ THOMAS A. RITTER

Thomas A. Ritter
Director and President & Chief Executive Officer

/s/ FRANK ELSNER, III

Frank Elsner, III
Director and Vice Chairman of the Board

/s/ MARIAN B. SCHULTZ

Marian B. Schultz
Director

/s/ RONALD L. HANKEY

Ronald L. Hankey
Director and Chairman of the Board

/s/ DAVID L. SITES

David L. Sites
Director

/s/ JAMES J. LOTT

James J. Lott
Director

/s/ ALAN J. STOCK

Alan J. Stock
Director

/s/ ROBERT W. MILLER

Robert W. Miller
Director

Jennifer L. Weaver
Director

/s/ DANIEL W. POTTS

Daniel W. Potts
Director

/s/ HARRY L. WHEELER

Harry L. Wheeler
Director

/s/ JAMES E. WILLIAMS

James E. Williams
Director