

Jonestown Bank & Trust Co. 2009 Annual Report





### **Northside Commons Office**

JBT's 9th community office opened in February 2010 at Northside Commons Shopping Center in Palmyra. This photo was taken during the final month of construction before exterior landscaping was completed.

# Table of Contents

2	Board of Directors and Executive Officers
3	Letter to Shareholders
4	Financial Highlights
5	Independent Auditor's Report
6	Balance Sheets
7	Statements of Income
8	Statements of Stockholders' Equity
9	Statements of Cash Flows
10	Notes to Financial Statements
36	Tribute to Howard M. Neuin

# Board of Directors



**Richard J. Newmaster, Jr.**  
Chairman and President  
Director since 2004;  
Vice President,  
Chief Financial Officer,  
Lebanon Seaboard Corp.



**Jeffrey L. Bohn**  
Vice Chairman  
Director since 1987;  
Co-owner,  
J.P. Donmoyer, Inc.



**Edward L. Anspach**  
Second Vice Chairman/  
Secretary  
Director since 1987;  
Chairman of  
Grantville Transit Authority;  
President, Anspach Autos.



**Lloyd A. Deaven, Jr.**  
Director since 1998;  
Fisher Auto Parts.



**Edwin C. Hostetter**  
Director since 1989;  
Retired retailer.



**Lee W. Sholly**  
Director since 1994;  
Retired banker.



**Richard S. Miller**  
Director since 1990;  
President,  
Richard S. Miller, Inc.



**Sallie A. Neuin**  
Director since 2009;  
Lebanon County  
Treasurer.



**Roger E. Gerhart**  
Director since 2008;  
President,  
Gerhart Machinery Company.



**Glenn T. Wenger**  
Director since 2008;  
President, Chairman,  
Wengers of Myerstown.

# Executive Officers



**Lynn R. Wenger**  
Chief Executive Officer



**Roger W. Jeremiah**  
Senior Vice  
President/Lending



**Joseph C. Lieb**  
VP/Operations  
Officer



**Terry L. Resanovich**  
VP/Senior Trust  
Officer



**C. William Roth**  
VP/Chief Financial  
Officer



**Troy A. Peters**  
VP/Sales/Marketing/  
Branch Administration

# Letter to Shareholders

**Richard J. Newmaster, Jr.**  
Chairman and President



**Lynn R. Wenger**  
Chief Executive Officer



In view of the economy and the regulatory pressures of the past year, we are happy to report that Jonestown Bank & Trust Co. had a successful year, with growth in assets of 11% and net income of \$2,650,000.

Net income was \$2,650,000 as of year end vs. \$2,951,000 at December 31, 2008, a decrease of 10.2%. Earnings per share were \$1.77 vs. \$1.97 for the previous year. The reduction was primarily a result of two factors: an increase in total payments for Federal Deposit Insurance of \$590,000 and provisions for loan losses of \$2,666,000 vs. \$1,315,000 in the previous year. In June the FDIC assessed all banks an additional one-time charge of five basis points on deposits in order to recapitalize the Federal Deposit Insurance Fund, payable on September 30, 2009. This special assessment alone was \$147,000 in addition to higher regular assessments. The higher provisions for loan losses are a combination of factors—a charge for a write-down on a lending relationship we had on our watch list, along with smaller write-downs for troubled debt, higher than normal consumer loan charge-offs due to the economy, and additions to the reserve for loan growth. Last year we reported 4.8% unemployment in Lebanon County, which has now escalated to 7% and we are feeling the effects of that change on consumer loans. Local businesses are reporting slower sales also—the slowdown in the economy has finally hit our area. The Bank’s ratio of non-performing loans to total loans is 2.41% vs. 1.78% for 2008. Loan loss allowance is now at 1.71% vs. 1.2% at December 31, 2008, while net charge-offs to total loans are .35% compared to .26% for 2008.

Assets reached \$333,861,000 as of December 31, 2009, compared to \$300,798,000 for the previous year, driven by net loan growth of 8%. Commercial loans led with a 15% increase over 2008, installment loans gained by 14%, and mortgages by 2%. Mortgage business was brisk in the first half of the year, helped by loan rates that are still fairly low. Gains on sale of mortgages for 2009 hit an all-time high, adding \$283,000 to income.

On the deposit side, we experienced 22% growth, primarily in money-market accounts and certificates of deposit. Our net interest margin improved from 3.80% to 3.83%, due to reduced longer term borrowings and lower cost of funds.

Despite the economic demands of the past year, our core banking principles and practices remain strong. We have not had to take any impairment charges on our investment portfolio as some banks have and our credit underwriting has been tightened. Our capital ratios remain within the “well capitalized” range and our strategic plan calls for continued growth. This environment, while challenging, still presents opportunities for additional market share and an expanded market area.

As we continue to grow, we will need to raise additional capital, to provide ongoing resources to make loans and invest in additional branching or acquisition opportunities. While the response to our Dividend Reinvestment Plan has been encouraging, it could be better. This is a simple and convenient way to make an additional investment in your bank at market rates. Last year the plan brought in \$80,000 in additional investment. If you have not already enrolled in the plan, your next opportunity to sign up will be in March and we encourage you to do so.

*(continued)*

# Letter to Shareholders *(continued)*

Your proxy material contains a proposed amendment and restatement of Article V of the Articles of Incorporation, changing the authorized shares from 3,000,000 to 6,000,000 shares of common stock at \$2.00 par value and authorizing 4,000,000 shares of blank check preferred stock without par value. A full explanation of this amendment is contained in the proxy statement and we encourage you to read this carefully and to vote for the amendment. It is crucial to the ongoing success of Jonestown Bank & Trust Co. to have more options to raise capital and preferred stock is a fairly simple way to do so. The authorization of additional common shares, likewise would allow the Bank to consider a common stock offering at some point in the future as a means to raise even more capital, thereby increasing future growth options.

In other news, our new branch at Northside Commons on Palmyra Road near Campbelltown will be open by the time you receive this report. We invite you to stop by and say hello if you are in the area. Once, again, we appreciate your continued interest in JBT.

Richard J. Newmaster, Jr.  
Chairman and President

Lynn R. Wenger  
Chief Executive Officer

## Financial Highlights

*(Dollars in thousands, except per share amounts)*

	2009	2008	Change
<b>Results of Operations</b>			
Net Interest Income	\$ 11,613	\$ 10,041	16 %
Provision for Loan Losses	2,666	1,315	103 %
Net Income	2,650	2,951	(10) %
<b>Per Share Data</b>			
Basic Earnings	\$ 1.77	\$ 1.97	(10) %
Cash Dividends	0.80	0.80	— %
Book Value	18.46	17.17	8 %
<b>Financial Condition at Year-End</b>			
Assets	\$ 333,861	\$ 300,798	11 %
Deposits	293,358	240,802	22 %
Loans Receivable, Net	273,734	252,997	8 %
Allowance for Loan Losses	4,776	3,087	55 %
Stockholders' Equity	27,702	25,754	8 %
<b>Financial Ratios</b>			
Return on Average Assets	0.79 %	1.04 %	(24) %
Return on Average Equity	9.82 %	11.55 %	(15) %
Total Capital to Risk Weighted Assets	10.85 %	11.05 %	(2) %

# Independent Auditor's Report

To the Board of Directors  
Jonestown Bank & Trust Co.  
Jonestown, Pennsylvania

We have audited the accompanying balance sheets of Jonestown Bank & Trust Co. as of December 31, 2009 and 2008, and the related statements of income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Jonestown Bank & Trust Co. as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "ParenteBeard LLC". The signature is written in a cursive, flowing style.

Reading, Pennsylvania  
February 9, 2010

# Balance Sheets

<i>(Dollars in thousands, except per share amounts)</i>	December 31,	
	2009	2008
<b>Assets</b>		
Cash and due from banks	\$ 12,291	\$ 5,457
Time certificates of deposit	—	388
Securities available for sale	25,264	19,232
Securities held to maturity	4,313	8,165
Loans receivable, net of allowance for loan losses 2009 \$4,776; 2008 \$3,087	273,734	252,997
Restricted investments in bank stock	2,179	2,042
Foreclosed assets	1,107	30
Bank premises and equipment, net	2,903	2,659
Investment in life insurance	5,632	5,445
Prepaid FDIC insurance assessment	1,540	—
Accrued interest receivable and other assets	4,898	4,383
<b>Total assets</b>	<b>\$333,861</b>	<b>\$300,798</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Deposits: Noninterest bearing	\$ 26,491	\$ 26,276
Interest bearing	266,867	214,526
Total deposits	293,358	240,802
Short-term borrowings	—	15,787
Long-term debt	11,092	16,273
Accrued interest payable and other liabilities	1,709	2,182
<b>Total liabilities</b>	<b>306,159</b>	<b>275,044</b>
<b>Stockholders' Equity</b>		
Common stock, par value \$2.00 per share; authorized 3,000,000 shares; issued and outstanding 1,500,123 shares for 2009 and 1,500,000 for 2008	3,000	3,000
Surplus	3,022	3,000
Retained earnings	21,420	20,005
Accumulated other comprehensive income (loss)	260	(251)
<b>Total stockholders' equity</b>	<b>27,702</b>	<b>25,754</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$333,861</b>	<b>\$300,798</b>

The accompanying notes are an integral part of these financial statements.

# Statements of Income

	Years Ended December 31,	
	2009	2008
<i>(Dollars in thousands, except per share amounts)</i>		
<b>Interest income</b>		
Loans receivable, including fees	<b>\$15,614</b>	\$14,860
Securities:		
Taxable	<b>947</b>	1,064
Tax-exempt	<b>268</b>	230
Other	<b>7</b>	88
<b>Total interest income</b>	<b>16,836</b>	16,242
<b>Interest expense</b>		
Deposits	<b>4,638</b>	5,307
Short-term borrowings	<b>46</b>	216
Long-term debt	<b>539</b>	678
<b>Total interest expense</b>	<b>5,223</b>	6,201
<b>Net interest income</b>	<b>11,613</b>	10,041
Provision for loan losses	<b>2,666</b>	1,315
<b>Net interest income after provision for loan losses</b>	<b>8,947</b>	8,726
<b>Other income</b>		
Trust income	<b>230</b>	208
Service charges on deposit accounts	<b>1,070</b>	1,128
Mortgage banking activities	<b>339</b>	203
Gain on sale of available-for-sale securities	<b>49</b>	—
Net gain (loss) on sale of foreclosed assets	<b>102</b>	(17)
Earnings on investment in life insurance	<b>228</b>	235
Other	<b>751</b>	742
<b>Total other income</b>	<b>2,769</b>	2,499
<b>Other expenses</b>		
Salaries and employee benefits	<b>3,937</b>	3,801
Occupancy	<b>570</b>	537
Equipment	<b>538</b>	534
Marketing	<b>261</b>	254
ATM processing fees	<b>307</b>	278
Pennsylvania bank shares tax	<b>216</b>	211
FDIC insurance assessment	<b>652</b>	62
Other	<b>1,566</b>	1,368
<b>Total other expenses</b>	<b>8,047</b>	7,045
<b>Income before income taxes</b>	<b>3,669</b>	4,180
Federal income taxes	<b>1,019</b>	1,229
<b>Net income</b>	<b>\$ 2,650</b>	\$ 2,951
Basic earnings per share	<b>\$1.77</b>	\$1.97
Weighted average number of shares outstanding	<b>1,500,580</b>	1,500,000

The accompanying notes are an integral part of these financial statements.

# Statements of Stockholders' Equity

Years Ended December 31, 2009 and 2008					
<i>(Dollars in thousands, except per share amounts)</i>	<b>Common Stock</b>	<b>Surplus</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Total</b>
<b>Balance, January 1, 2008</b>	\$3,000	\$3,000	\$18,626	\$ 126	\$24,752
Cumulative effect of adoption of new accounting principle - accounting for deferred compensation aspects of split dollar life insurance arrangements (EITF 06-4)	—	—	(349)	—	(349)
Effect of changing pension plan measurement date pursuant to SFAS No. 158, net of tax	—	—	(23)	—	(23)
Comprehensive income:					
Net income	—	—	2,951	—	2,951
Other comprehensive loss, net of tax	—	—	—	(377)	(377)
Total comprehensive income					2,574
Cash dividends on common stock (\$0.80 per share)	—	—	(1,200)	—	(1,200)
<b>Balance, December 31, 2008</b>	3,000	3,000	20,005	(251)	25,754
Purchases and retirement of common stock (3,475 shares)	<b>(7)</b>	<b>(51)</b>	<b>(35)</b>	—	<b>(93)</b>
Issuance of common stock through dividend reinvestment plan (3,598 shares)	<b>7</b>	<b>73</b>	—	—	<b>80</b>
Comprehensive income:					
Net income	—	—	<b>2,650</b>	—	<b>2,650</b>
Other comprehensive income, net of tax	—	—	—	<b>511</b>	<b>511</b>
Total comprehensive income					<b>3,161</b>
Cash dividends on common stock (\$0.80 per share)	—	—	<b>(1,200)</b>	—	<b>(1,200)</b>
<b>Balance, December 31, 2009</b>	<b>\$3,000</b>	<b>\$3,022</b>	<b>\$21,420</b>	<b>\$ 260</b>	<b>\$27,702</b>

The accompanying notes are an integral part of these financial statements.

# Statements of Cash Flows

<i>(Dollars in thousands)</i>	<b>Years Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash Flows From Operating Activities</b>		
Net income	<b>\$ 2,650</b>	\$ 2,951
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	<b>2,666</b>	1,315
Provision for depreciation and amortization	<b>378</b>	376
Net amortization of securities premiums and discounts	<b>94</b>	26
Net realized (gain) loss on sale of foreclosed assets	<b>(102)</b>	(17)
Net realized gain on sale of securities	<b>(49)</b>	—
Deferred income taxes	<b>(595)</b>	(110)
Proceeds from sales of loans	<b>18,962</b>	9,974
Gains on sales of loans	<b>(283)</b>	(135)
Loans originated for sale	<b>(18,679)</b>	(9,814)
Net loss on sale of premises and equipment	<b>—</b>	3
Increase in investment in life insurance	<b>(187)</b>	(195)
Increase in prepaid FDIC insurance assessment	<b>(1,540)</b>	—
Increase in accrued interest receivable and other assets	<b>(285)</b>	(796)
Increase in accrued interest payable and other liabilities	<b>(324)</b>	32
Net cash provided by operating activities	<b>2,706</b>	3,610
<b>Cash Flows From Investing Activities</b>		
Proceeds from maturities and principal repayments of:		
Securities held to maturity	<b>3,882</b>	3,475
Securities available for sale	<b>3,787</b>	3,888
Proceeds from sale of available for sale securities	<b>1,049</b>	—
Purchase of securities available for sale	<b>(10,317)</b>	(6,781)
Net decrease in time certificates of deposit	<b>388</b>	252
Net increase in loans	<b>(24,898)</b>	(39,948)
Net increase in restricted investment in bank stock	<b>(137)</b>	(326)
Purchases of bank premises and equipment	<b>(521)</b>	(104)
Proceeds from sale of foreclosed assets	<b>520</b>	526
Proceeds from sale of premises and equipment	<b>—</b>	11
Net cash used in investing activities	<b>(26,247)</b>	(39,007)
<b>Cash Flows From Financing Activities</b>		
Net increase in deposits	<b>52,556</b>	30,129
Decrease in short-term borrowings	<b>(15,787)</b>	(2,034)
Proceeds from long-term debt	<b>—</b>	8,850
Repayment of long-term debt	<b>(5,181)</b>	(1,839)
Proceeds from issuance of common stock	<b>80</b>	—
Purchases of common stock	<b>(93)</b>	—
Dividends paid	<b>(1,200)</b>	(1,200)
Net cash provided by financing activities	<b>30,375</b>	33,906
Increase (decrease) in cash and cash equivalents	<b>6,834</b>	(1,491)
<b>Cash and cash equivalents:</b>		
Beginning balance	<b>5,457</b>	6,948
Ending balance	<b>\$12,291</b>	\$ 5,457
Cash payments for: Interest	<b>\$ 5,317</b>	\$ 6,191
Income taxes	<b>\$ 1,305</b>	\$ 1,660
Transfer of loans to foreclosed assets	<b>\$ 1,495</b>	\$ 422

The accompanying notes are an integral part of these financial statements.

# Notes to Financial Statements

## 1 Summary of Significant Accounting Policies

### ***Nature of operations:***

The Bank operates under a state bank charter and provides full banking services, including trust services. As a state bank, the Bank is subject to regulation of the Pennsylvania Department of Banking and the Federal Deposit Insurance Corporation. The area served by the Bank is principally Lebanon County, Pennsylvania.

### ***Estimates:***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those 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 determination of impairment of restricted investment in bank stock and of other-than-temporary impairment of securities.

### ***Subsequent Events:***

The Bank has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2009 for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through February 9, 2010, the date these financial statements were issued.

### ***Presentation of cash flows:***

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and federal funds sold, if any.

### ***Securities:***

Securities classified as available for sale are those securities that the Bank intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Bank's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported in other comprehensive income, net of the related deferred tax effect. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

# Notes to Financial Statements

## 1 Summary of Significant Accounting Policies (continued)

### ***Securities (continued):***

Bonds, notes and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the terms of the securities.

Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designation as of each balance sheet date.

Effective April 1, 2009, the Bank adopted new accounting guidance related to recognition and presentation of other-than-temporary impairment FASB ASC 320-10. This recent accounting guidance amends the recognition guidance for other-than-temporary impairments of debt securities and expands the financial statement disclosures for other-than-temporary impairment losses on debt and equity securities. The recent guidance replaced the “intent and ability” indication in current guidance by specifying that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the noncredit portion of a previous other-than-temporary impairment should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

Prior to the adoption of the recent accounting guidance, management considered, in determining whether other-than-temporary impairment exists, (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

### ***Restricted investments in bank stock:***

Restricted investments in bank stock, which represents required investments in the common stock of correspondent banks, is carried at cost and as of December 31, 2009 and 2008, consists of the common stock of Federal Home Loan Bank of Pittsburgh (FHLB) and Atlantic Central Bankers Bank (ACBB). Federal law requires a member institution of the FHLB to hold stock of its district FHLB according to a predetermined formula. In December 2008, the FHLB of Pittsburgh notified member banks that it was suspending dividend payments and the repurchase of capital stock. As of December 31, 2009 and 2008, the recorded investment in FHLB common stock is \$2,159,000 and \$2,022,000, respectively.

# Notes to Financial Statements

## 1 Summary of Significant Accounting Policies (continued)

### ***Restricted investments in bank stock (continued):***

Management evaluates the restricted stock for impairment in accordance with FASB ASC 942-10. 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 FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

Management believes no impairment charge is necessary related to the restricted stock as of December 31, 2009.

### ***Loans held for sale:***

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Loans held for sale and included in loans receivable at December 31, 2009 and 2008 were \$-0-.

Mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the Bank; however, the Bank does sell some mortgage loans with servicing released. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated mortgage servicing rights. 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 receivable:***

The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout Lebanon County, Pennsylvania. The ability of the Bank'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 payoff generally are stated at their outstanding unpaid principal balances, net of 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 yield (interest income) of the related loans. The Bank is generally amortizing these amounts over the contractual life of the loan.

# Notes to Financial Statements

## 1 Summary of Significant Accounting Policies (continued)

### ***Loans receivable (continued):***

The accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due unless the credit is well secured and in the process of collection, or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

### ***Allowance for loan losses:***

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

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component 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.

# Notes to Financial Statements

## 1 Summary of Significant Accounting Policies (continued)

### ***Allowance for loan losses (continued):***

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreements. 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 real estate 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.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are subject to a restructuring agreement.

### ***Servicing:***

Servicing assets are recognized as separate assets when rights are acquired through the sale of loans. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum.

### ***Foreclosed assets:***

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

# Notes to Financial Statements

## 1 Summary of Significant Accounting Policies (continued)

### ***Bank premises and equipment:***

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed principally on the straight-line method over the estimated useful lives of the related assets, ranging from 3 to 30 years.

### ***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 Bank, (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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

### ***Investment in life insurance:***

The Bank invests in bank owned life insurance (“BOLI”) as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Bank on a chosen group of employees. The Bank is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from the increase in cash surrender value of the policies is included in other income on the income statement.

In September 2006, the FASB reached a consensus on the guidance provided by ASC Topic 715-60 (Codification), *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Insurance Arrangements*. The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policy, that are associated with a postretirement benefit. FASB Topic ASC 715-60 requires that when a split-dollar life insurance arrangement within the scope of the Issue exists, an employer should recognize a liability for future benefits based on the substantive agreement with the employee. FASB Topic ASC 715-60 was effective on January 1, 2008 for the Bank. As a result of adopting this standard, the Bank recorded a cumulative effect adjustment of \$349,000 to retained earnings effective January 1, 2008. In addition, the related expense recorded in 2009 and 2008 was approximately \$48,000 and \$47,000, respectively.

### ***Trust assets:***

Assets held by the Bank in a fiduciary capacity for customers are not included in the financial statements since such items are not assets of the Bank. Trust income is reported on the accrual method.

# Notes to Financial Statements

## 1 Summary of Significant Accounting Policies (continued)

### ***Income taxes:***

Deferred taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

### ***Advertising:***

Advertising costs are expensed as incurred.

### ***Off-balance sheet financial instruments:***

In the ordinary course of business, the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. Such financial instruments are recorded in the balance sheet when they are funded.

### ***Earnings per share:***

The Bank has a simple capital structure. Basic earnings per share represents net income divided by the weighted average number of shares outstanding during the period.

### ***Comprehensive income:***

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, and unrecognized gains and losses, prior service costs, and transition assets or obligations for defined benefit pension plans are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

# Notes to Financial Statements

## 1 Summary of Significant Accounting Policies (continued)

### **Comprehensive income (continued):**

The components of other comprehensive income (loss) and related tax effects are presented in the following table:

<i>(Dollars in 000's)</i>	<b>Years Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during the year	\$ 633	\$ (78)
Reclassification adjustment for gains included in net income	(49)	—
Reclassification adjustment for unrealized losses remaining to be amortized from transfer of available for sale securities to held to maturity	43	46
Net unrealized gains (losses)	627	(32)
Defined benefit pension plan:		
Prior service cost	(45)	(61)
Net loss	192	(478)
Other comprehensive income (loss) before tax	774	(571)
Tax effect	(263)	194
Other comprehensive income (loss)	\$ 511	\$ (377)

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

<i>(Dollars in 000's)</i>	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Unrealized gains on securities available for sale	\$ 462	\$ 78
Unamortized unrealized losses on securities held to maturity	(21)	(50)
Unrecognized pension losses	(181)	(279)
	\$ 260	\$ (251)

# Notes to Financial Statements

## 2 Restrictions on Cash and Due From Bank Balances

The Bank is required to maintain cash reserve balances in vault cash and with the Federal Reserve Bank. The required reserve balances at December 31, 2009 and 2008 were \$250,000 and \$379,000, respectively.

## 3 Securities

The amortized cost and fair value of securities are presented in the following tables.

<b>December 31, 2009</b>					
<i>(Dollars in 000's)</i>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>		<b>Fair Value</b>
<b>Available for sale securities:</b>					
State and political subdivisions	\$ 8,062	\$ 130	\$ (4)	\$	8,188
Mortgage-backed securities	16,502	579	(5)		17,076
	<b>\$ 24,564</b>	<b>\$ 709</b>	<b>\$ (9)</b>	<b>\$</b>	<b>25,264</b>
<b>Held to maturity securities:</b>					
State and political subdivisions	\$ 500	\$ 2	\$ —	\$	502
Mortgage-backed securities	3,813	196	(4)		4,005
	<b>\$ 4,313</b>	<b>\$ 198</b>	<b>\$ (4)</b>	<b>\$</b>	<b>4,507</b>
<b>December 31, 2008</b>					
<i>(Dollars in 000's)</i>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>		<b>Fair Value</b>
<b>Available for sale securities:</b>					
U.S. Government agencies	\$ 1,998	\$ 76	\$ —	\$	2,074
State and political subdivisions	4,145	9	(128)		4,026
Mortgage-backed securities	12,973	206	(47)		13,132
	<b>\$ 19,116</b>	<b>\$ 291</b>	<b>\$ (175)</b>	<b>\$</b>	<b>19,232</b>
<b>Held to maturity securities:</b>					
U.S. Government agencies	\$ 983	\$ 25	\$ —	\$	1,008
State and political subdivisions	1,973	10	—		1,983
Mortgage-backed securities	5,209	128	(5)		5,332
	<b>\$ 8,165</b>	<b>\$ 163</b>	<b>\$ (5)</b>	<b>\$</b>	<b>8,323</b>

# Notes to Financial Statements

## 3 Securities (continued)

Securities with a fair value of \$11,695,000 and \$16,411,000 at December 31, 2009 and 2008, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

Two securities were sold in 2009 resulting in a gain of \$49,000. No securities were sold in 2008.

During 2004, the Bank transferred \$14,535,000 of securities from securities available for sale to securities held to maturity. The securities were transferred at their fair value on the date of transfer which was \$406,000 less than the amortized cost of the securities. This difference was reflected as a component of accumulated other comprehensive income (loss) and is being amortized over the period to maturity of the respective securities. At December 31, 2009, \$21,000 of this difference, net of taxes of \$12,000 remains unamortized.

The amortized cost and fair value of securities by contractual maturity are shown in the following table. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties.

December 31, 2009	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<i>(Dollars in 000's)</i>				
Due in one year or less	\$ —	\$ —	\$ 200	\$ 201
Due after one year through five years	250	262	300	301
Due after five years through ten years	2,080	2,105	—	—
Due after ten years	5,732	5,821	—	—
Mortgage-backed securities	16,502	17,076	3,813	4,005
	<b>\$ 24,564</b>	<b>\$ 25,264</b>	<b>\$ 4,313</b>	<b>\$ 4,507</b>

The following table shows the Bank'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, 2009 and 2008.

December 31, 2009	Less than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(Dollars in 000's)</i>						
<b>Available for sale securities:</b>						
State and political subdivisions	\$ 1,613	\$ (4)	\$ —	\$ —	\$ 1,613	\$ (4)
Mortgage-backed securities	982	(4)	128	(1)	1,110	(5)
	<b>\$ 2,595</b>	<b>(8)</b>	<b>128</b>	<b>(1)</b>	<b>2,723</b>	<b>(9)</b>
<b>Held to maturity securities:</b>						
Mortgage-backed securities	\$ 413	(1)	26	(3)	439	(4)
<b>Total</b>	<b>\$ 3,008</b>	<b>\$ (9)</b>	<b>\$ 154</b>	<b>\$ (4)</b>	<b>\$ 3,162</b>	<b>\$ (13)</b>

# Notes to Financial Statements

## 3 Securities (continued)

December 31, 2008	Less than Twelve Months		Twelve Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<i>(Dollars in 000's)</i>						
<b>Available for sale securities:</b>						
State and political subdivisions	\$ 2,181	\$ (59)	\$ 1,585	\$ (69)	\$ 3,766	\$ (128)
Mortgage-backed securities	3,100	(37)	691	(10)	3,791	(47)
	5,281	(96)	2,276	(79)	7,557	(175)
<b>Held to maturity securities:</b>						
Mortgage-backed securities	221	(3)	39	(2)	260	(5)
<b>Total</b>	<b>\$ 5,502</b>	<b>\$ (99)</b>	<b>\$ 2,315</b>	<b>\$ (81)</b>	<b>\$ 7,817</b>	<b>\$ (180)</b>

In management's opinion, the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. At December 31, 2009, the Bank had 11 securities in an unrealized loss position, none of which exceeded 10% of the securities carrying amount.

Management believes that the unrealized losses are temporary and the Bank (a) does not have the intent to sell any of the debt securities prior to recovery and (b) it is more likely than not that it will not have to sell any of the debt securities prior to recovery.

## 4 Loans Receivable and Allowance for Loan Losses

Loans receivable consist of the following:

<i>(Dollars in 000's)</i>	December 31,	
	2009	2008
Commercial and commercial real estate	<b>\$ 96,467</b>	\$ 84,639
Consumer	<b>77,033</b>	68,231
Residential real estate	<b>103,904</b>	102,230
Total Loans	<b>277,404</b>	255,100
Allowance for loan losses	<b>(4,776)</b>	(3,087)
Net deferred costs	<b>1,106</b>	984
Net loans receivable	<b>\$273,734</b>	\$252,997

# Notes to Financial Statements

## 4 Loans Receivable and Allowance for Loan Losses (continued)

The following table presents changes in the allowance for loan losses.

<i>(Dollars in 000's)</i>	Years Ended December 31,	
	2009	2008
Beginning balance	\$ 3,087	\$ 2,398
Provision for loan losses	2,666	1,315
Loans charged off	(1,335)	(867)
Recoveries	358	241
Ending balance	\$ 4,776	\$ 3,087

The following is a summary of impaired and non-performing loans:

<i>(Dollars in 000's)</i>	As of and for the Year Ended December 31,	
	2009	2008
Impaired loans not requiring a valuation allowance	\$ 1,524	\$ 909
Impaired loans with a valuation allowance	4,850	3,547
Valuation allowance related to impaired loans	1,158	92
Average investment in impaired loans	6,668	4,726
Interest income recognized on impaired loans	—	32
Nonaccrual loans	4,940	3,931
Loans greater than 90 days past due and still accruing	615	716

The Bank entered into agreements to sell residential mortgages to the FHLB of Pittsburgh ("FHLB"). The total amount of loans sold under these agreements was \$86,727,000 and \$68,048,000 as of December 31, 2009 and 2008, respectively. The agreements include a maximum credit enhancement of \$2,402,500, which the Bank may be required to pay if realized losses on any of the sold mortgages exceed the amount held in the FHLB's Spread Account. The FHLB is funding the Spread Account at 0.04% of the outstanding balance of loans sold annually. The Bank's historical losses on residential mortgages have been lower than the amount that will be funded to the Spread Account. Therefore, the Bank has not recorded a liability for the credit enhancement. As compensation for the credit enhancement, the FHLB is paying the Bank 0.10% of the outstanding loan balance in the portfolio on a monthly basis.

Loans serviced for others are not included in the accompanying balance sheets. The unpaid principal balances of mortgage loans serviced for others were \$47,057,000 and \$39,070,000 at December 31, 2009 and 2008, respectively.

The Bank retains the servicing on certain loans sold to the FHLB and receives a fee based upon the principal balance outstanding. The balance of mortgage servicing rights included in other assets was \$225,000 at December 31, 2009 and \$178,000 at December 31, 2008.

# Notes to Financial Statements

## 4 Loans Receivable and Allowance for Loan Losses (continued)

The following summarizes mortgage servicing rights capitalized and amortized:

<i>(Dollars in 000's)</i>	Years Ended December 31,	
	2009	2008
Mortgage servicing rights capitalized	\$ 141	\$ 47
Mortgage servicing rights amortized	94	65

## 5 Bank Premises and Equipment

Components of bank premises and equipment are as follows:

<i>(Dollars in 000's)</i>	December 31,	
	2009	2008
Land and land improvements	\$ 456	\$ 456
Buildings	4,080	3,767
Furniture and equipment	2,730	2,523
Total premises and equipment	7,266	6,746
Less accumulated depreciation	(4,363)	(4,087)
Net premises and equipment	\$ 2,903	\$ 2,659

The Bank leases land and office space under operating leases. Rental expense, including real estate taxes, for these leases was \$93,000 and \$84,000 for the years ended December 31, 2009 and 2008, respectively. Future minimum rental commitments under these leases are as follows:

<i>(Dollars in 000's)</i>	Years Ending December 31,
2010	\$ 124
2011	131
2012	131
2013	135
2014	138
Thereafter	1,741
	\$ 2,400

# Notes to Financial Statements

## 6 Deposits

The composition of deposits is as follows:

<i>(Dollars in 000's)</i>	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Demand, noninterest bearing	<b>\$ 26,491</b>	\$ 26,276
Checking with interest and money market	<b>102,262</b>	81,465
Savings	<b>20,721</b>	18,825
Time deposits of \$100,000 or more	<b>47,838</b>	25,742
Other time deposits	<b>96,046</b>	88,494
	<b>\$293,358</b>	\$240,802

At December 31, 2009, the scheduled maturities of time deposits are as follows:

<i>(Dollars in 000's)</i>	<b>Years Ending December 31,</b>
2010	<b>\$ 93,639</b>
2011	<b>27,776</b>
2012	<b>9,307</b>
2013	<b>10,929</b>
2014	<b>2,233</b>
	<b>\$143,884</b>

## 7 Employee Benefits

The Bank has a defined contribution 401(k) plan for employees who meet the eligibility requirements set forth in the plan. Substantially all of the Bank's full-time employees are covered by the plan. The Bank matches \$0.75 for each \$1.00, up to 4% of compensation that each employee that is covered by the Bank's defined benefit pension plan contributes. For all other employees, the match is 100% up to 4% of compensation. The Bank's contributions to this plan were \$95,000 in 2009 and \$91,000 in 2008.

The Bank has a noncontributory defined benefit pension plan (the "Plan") covering substantially all employees hired prior to February 1, 2006. The Plan's benefit formulas generally base payments to retired employees upon their length of service and the employees' average monthly compensation.

# Notes to Financial Statements

## 7 Employee Benefits (continued)

In 2008, the Bank adopted a change in accounting for defined benefit pension and other post retirement plans (FASB ASC 715-20). This guidance requires that defined benefit plan assets and obligations are to be measured as of the date of the employer's fiscal year end. To reflect this change, the Bank recorded a \$23,000 (after tax) reduction to the 2008 beginning balance of retained earnings.

The following table sets forth the plan's funded status and the amounts recognized in the Bank's financial statements. The measurement date for purposes of these valuations was December 31, 2009 and 2008.

<i>(Dollars in 000's)</i>	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Obligations and funded status:		
Change in benefit obligation:		
Benefit obligation beginning of year	<b>\$2,178</b>	\$1,928
Service cost	<b>220</b>	246
Interest cost	<b>127</b>	143
Actuarial (gain) loss	<b>(32)</b>	(4)
Experience (gain) loss	<b>26</b>	(56)
Benefit payments	<b>(186)</b>	(79)
Benefit obligation at end of year	<b>2,333</b>	2,178
Change in plan assets:		
Fair value of plan assets at beginning of year	<b>1,463</b>	1,750
Employer contributions	<b>225</b>	180
Actual return on plan assets	<b>250</b>	(388)
Benefits payments	<b>(186)</b>	(79)
Fair value of plan assets at end of year	<b>1,752</b>	1,463
Funded status	<b>\$ (581)</b>	\$ (715)
Amounts related to the plan have been recognized in accumulated other comprehensive income (loss) as follows:		
Prior service cost	<b>\$ (289)</b>	\$ (334)
Net (gain) or loss	<b>564</b>	756
	<b>\$ 275</b>	\$ 422

# Notes to Financial Statements

## 7 Employee Benefits (continued)

Net periodic pension expense included the following components:

<i>(Dollars in 000's)</i>	Years Ended December 31,	
	2009	2008
Service cost	\$ 220	\$ 196
Interest cost	127	115
Expected return on plan assets	(106)	(126)
Net amortization and deferral	(3)	(42)
Net periodic pension expense	\$ 238	\$ 143

The accumulated benefit obligation was \$2,333,000 and \$1,869,000 at December 31, 2009 and 2008, respectively.

The following is a summary of actuarial assumptions used for the Bank's pension plan:

	2009	2008
Discount rate	5.96%	5.87%
Average rate of increase in compensation levels	4.50%	4.50%
Expected long-term rate of return on plan assets	7.00%	7.00%

The selected long-term rate of return on plan assets (7.0%) was primarily based on the asset allocation of the Plan's assets. Analysis of the historic returns on these asset classes and projections of expected future returns were considered in setting the long-term rate of return.

Following is a description of the valuation methodologies used for investments measured at fair value within the Bank's pension plan. There have been no significant changes in the methodologies used during the year ended December 31, 2009. Similar valuation methodologies were used to value the Bank's pension plan's investments as of December 31, 2008.

### Level 1 Fair Value Measurement

Investments in cash are stated at cost, which approximates fair value. The fair values of money fund and mutual funds are based on quoted net asset values of the shares held by the Bank's pension plan at year-end.

### Level 2 and Level 3 Fair Value Measurement

The Plan does not hold any level 2 or level 3 investments.

# Notes to Financial Statements

## 7 Employee Benefits (continued)

The fair value of the Bank's pension plan assets at December 31, 2009 and 2008, by asset category are as follows:

Description	December 31, 2009	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
<i>(Dollars in Thousands)</i>				
Mutual Funds	\$ 1,700	\$ 1,700	\$ —	\$ —
Money Funds	46	46	—	—
Cash	6	6	—	—
	\$ 1,752	\$ 1,752	\$ —	\$ —

Description	December 31, 2008	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
<i>(Dollars in Thousands)</i>				
Mutual Funds	\$ 1,400	\$ 1,400	\$ —	\$ —
Money Funds	49	49	—	—
Cash	14	14	—	—
	\$ 1,463	\$ 1,463	\$ —	\$ —

The Bank's pension plan has no financial assets measured at fair value on a nonrecurring basis for the years ended December 31, 2009 and 2008.

The Bank expects to contribute \$210,000 to its pension plan in 2010.

# Notes to Financial Statements

## 7 Employee Benefits (continued)

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

<i>(Dollars in 000's)</i>	<b>Years Ending December 31,</b>
2010	<b>\$ 29</b>
2011	<b>29</b>
2012	<b>72</b>
2013	<b>79</b>
2014	<b>108</b>
2015 - 2019	<b>707</b>

## 8 Income Taxes

The provision for federal income taxes consisted of the following:

<i>(Dollars in 000's)</i>	<b>Years Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Current	<b>\$ 1,614</b>	\$ 1,339
Deferred	<b>(595)</b>	(110)
	<b>\$ 1,019</b>	\$ 1,229

Reconciliation of the statutory income tax expense computed at 34% to the income tax expense included in the statements of income is as follows:

<i>(Dollars in 000's)</i>	<b>Years Ended December 31,</b>			
	<b>2009</b>		<b>2008</b>	
	Amount	%	Amount	%
Computed statutory tax expense	<b>\$ 1,248</b>	<b>34.0</b>	\$ 1,421	34.0
Tax exempt interest, net	<b>(183)</b>	<b>(5.0)</b>	(144)	(3.5)
Life insurance	<b>(47)</b>	<b>(1.3)</b>	(51)	(1.2)
Other, net	<b>1</b>	<b>0.1</b>	3	0.1
	<b>\$ 1,019</b>	<b>27.8</b>	\$ 1,229	29.4

# Notes to Financial Statements

## 8 Income Taxes (continued)

Net deferred tax assets consisted of the following components.

<i>(Dollars in 000's)</i>	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Deferred tax assets:		
Allowance for loan losses	\$ 1,426	\$ 804
Accrued pension	199	244
Other	5	5
<b>Total deferred tax assets</b>	<b>1,630</b>	1,053
Deferred tax liabilities:		
Net unrealized gains on securities	(227)	(13)
Bank premises and equipment	(215)	(202)
Mortgage servicing rights	(76)	(60)
Securities accretion	(36)	(36)
Prepaid expenses	(87)	(74)
Other	(18)	(28)
<b>Total deferred tax liabilities</b>	<b>(659)</b>	(413)
<b>Net deferred tax assets</b>	<b>\$ 971</b>	\$ 640

## 9 Borrowed Funds

The Bank has available a \$20 million line with the Federal Home Loan Bank of Pittsburgh (FHLB). This line expires in February 2012. The interest rate on this line was 0.62% at December 31, 2009 and 0.59% at December 31, 2008. The outstanding balance under this line was \$0- and \$15,787,000 as of December 31, 2009 and 2008, respectively.

Long-term debt is comprised of the following FHLB fixed-rate advances:

<i>(Dollars in 000's)</i>	<b>Maturity Date</b>	<b>Rate</b>	<b>Payment</b>	<b>December 31,</b>	
				<b>2009</b>	<b>2008</b>
	January 2009	5.31%	\$27/qtr	\$ —	\$ 2,000
	March 2009	2.65%	96/mo	—	287
	July 2009	5.29%	27/qtr	—	2,079
	January 2010	3.68%	28/qtr	3,000	3,000
	January 2011	3.77%	19/qtr	2,000	2,000
	August 2013	4.10%	62/mo	2,535	3,163
	May 2023	4.57%	19/mo	2,309	2,431
	May 2023	4.68%	10/mo	1,248	1,313
				<b>\$11,092</b>	\$16,273

# Notes to Financial Statements

## 9 Borrowed Funds (continued)

The contractual maturities of long-term debt at December 31, 2009 are:

<i>(Dollars in 000's)</i>	
2010	\$ 3,850
2011	2,886
2012	926
2013	714
2014	237
Thereafter	2,479
	<b>\$11,092</b>

Borrowings from the FHLB are collateralized by certain qualifying assets of the Bank. The Bank has a maximum borrowing capacity with the FHLB of approximately \$108 million at December 31, 2009 of which \$11 million was outstanding.

## 10 Related Party Transactions

The Bank has had banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders and their affiliated companies (related parties) on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. At December 31, 2009 and 2008, these persons were indebted to the Bank for loans totaling \$1,816,000 and \$428,000, respectively. During 2009, \$1,462,000 of new loans were made and repayments totaled \$74,000.

## 11 Off-Balance Sheet Commitments

The Bank 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 include commitments to extend credit and letters of credit. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

# Notes to Financial Statements

## 11 Off-Balance Sheet Commitments (continued)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Outstanding letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral supporting these letters of credit as 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 amount of the liability as of December 31, 2009 and 2008 for guarantees under standby letters of credit issued is not material.

A summary of the Bank's financial instrument commitments is as follows:

<i>(Dollars in 000's)</i>	December 31,	
	2009	2008
Commitments to grant loans	\$ 8,063	\$ 9,807
Unfunded commitments under lines of credit	33,070	30,758
Outstanding letters of credit	8,727	7,315

## 12 Concentration of Credit Risk

The Bank grants commercial, residential and consumer loans to customers primarily located in Lebanon County, Pennsylvania. The concentrations of credit by type of loan are set forth in Note 4. Although the Bank has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy.

# Notes to Financial Statements

## 13 Regulatory Matters

The Bank 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 the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's 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 Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2009, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2009, the most recent notification from the Federal Deposit Insurance Corporation 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.

The Bank's actual capital amounts and ratios as of December 31 are also presented below.

		Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
		Amount	Ratio	≥ Amount	≥ Ratio	≥ Amount	≥ Ratio
<b>Total capital (to risk weighted assets)</b>							
<b>2009</b>	<b>\$ 31,009</b>	<b>10.85%</b>	<b>\$ 22,864</b>	<b>8.00%</b>	<b>\$ 28,580</b>	<b>10.00%</b>	
2008	\$ 28,811	11.05%	\$ 20,840	8.00%	\$ 26,050	10.00%	
<b>Tier I Capital (to risk weighted assets)</b>							
<b>2009</b>	<b>\$ 27,408</b>	<b>9.61%</b>	<b>\$ 11,432</b>	<b>4.00%</b>	<b>\$ 17,148</b>	<b>6.00%</b>	
2008	\$ 25,708	9.86%	\$ 10,420	4.00%	\$ 15,630	6.00%	
<b>Tier I Capital (to average assets)</b>							
<b>2009</b>	<b>\$ 27,411</b>	<b>8.26%</b>	<b>\$ 13,274</b>	<b>4.00%</b>	<b>\$ 16,593</b>	<b>5.00%</b>	
2008	\$ 25,708	8.63%	\$ 11,913	4.00%	\$ 14,891	5.00%	

The Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. At December 31, 2009, \$21,420,000 of retained earnings was available for dividend declaration without prior regulatory approval, subject to the above regulatory capital requirements.

# Notes to Financial Statements

## 14 Fair Values of Financial Instruments

Management uses its best judgment in estimating the fair value of the Bank'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 Bank could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these 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 year-end.

The Fair Value Measurements and Disclosure topic of FASB ASC 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 under the Fair Value Measurements and Disclosure Topic of FASB ASC 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's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2009 and 2008 are as follows:

Description	December 31, 2009	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
<i>(Dollars in Thousands)</i>				
Securities available for sale	\$ 25,264	\$ —	\$ 25,264	\$ —

# Notes to Financial Statements

## 14 Fair Values of Financial Instruments (continued)

Description	December 31, 2008	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
<i>(Dollars in Thousands)</i>				
Securities available for sale	\$ 19,232	\$ —	\$ 19,232	\$ —

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2009 are as follows:

Description	December 31, 2009	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
<i>(Dollars in Thousands)</i>				
Impaired loans	\$ 3,692	\$ —	\$ —	\$ 3,692

The following information should not be interpreted as an estimate of the fair value of the entire Bank since a fair value calculation is only provided for a limited portion of the Bank'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 Bank'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 Bank's financial instruments at December 31, 2009 and 2008.

### **Cash and cash equivalents:**

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets' fair values.

### **Time certificates of deposit:**

The carrying amount of time certificates of deposit approximates its fair value.

### **Securities:**

The Bank utilizes a third party source to determine the fair value of its securities available for sale (carried at fair value) and held to maturity (carried at amortized cost). The methodology consists of pricing models based on asset class and includes available trade, bid, other market information, broker quotes, proprietary models, various databases and trading desk quotes, some of which are heavily influenced by unobservable inputs.

# Notes to Financial Statements

## 14 Fair Values of Financial Instruments (continued)

### ***Loans receivable:***

For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for other loans (e.g., residential real estate and consumer loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Fair value of impaired loans 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 of \$4,850,000 less their specific valuation allowances of \$1,158,000.

### ***Restricted investment in bank stock:***

The carrying amount of restricted investment in bank stock approximates fair value.

### ***Accrued interest receivable and payable:***

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

### ***Mortgage servicing rights:***

The fair value of mortgage servicing rights is based on observable market prices when available or the present value of expected future cash flows.

### ***Deposit liabilities:***

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

### ***Short-term borrowings:***

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

### ***Long-term debt:***

Fair values of long-term debt are estimated using discounted cash flow analysis, based on rates currently available to the Bank for advances from the FHLB with similar terms and remaining maturities.

# Notes to Financial Statements

## 14 Fair Values of Financial Instruments (continued)

### *Off-balance sheet financial instruments:*

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

The estimated fair values of the Bank's financial instruments were as follows at December 31, 2009 and 2008.

December 31,	2009		2008	
<i>(Dollars in 000's)</i>	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and due from banks	<b>\$ 12,291</b>	<b>\$ 12,291</b>	\$ 5,457	\$ 5,457
Time certificates of deposit	—	—	388	388
Securities	<b>29,577</b>	<b>29,771</b>	27,397	27,555
Loans, net of allowance	<b>273,734</b>	<b>290,442</b>	252,997	272,520
Accrued interest receivable	<b>2,987</b>	<b>2,987</b>	2,387	2,387
Restricted investment in bank stock	<b>2,179</b>	<b>2,179</b>	2,042	2,042
Mortgage servicing rights	<b>224</b>	<b>224</b>	178	178
<b>Financial liabilities:</b>				
Deposits	<b>293,358</b>	<b>295,732</b>	240,802	244,299
Short-term borrowings	—	—	15,787	15,787
Long-term debt	<b>11,092</b>	<b>11,578</b>	16,273	17,240
Accrued interest payable	<b>327</b>	<b>327</b>	421	421
<b>Off-balance sheet financial instruments:</b>				
Commitments to extend credit	—	—	—	—
Stand by letters of credit	—	—	—	—

## 15 Contingencies

The Bank 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 Bank 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 financial position, results of operations or liquidity of the Bank.

# JBT Honors Howard M. Neuin

Howard M. Neuin retired from the Board of Directors of Jonestown Bank & Trust Co. on March 10, 2009. The Board voted at that time to make him Director Emeritus, in recognition of his 28 years of service to the organization in many capacities. Howard not only invested his money in the Bank, but much of his time since 1981, as a member of the building committee, where his expertise as a contractor proved invaluable, along with other committees until his appointment to the executive committee in 1987 as Vice President. In 1990 he was elected President and led the organization to success through the remaining 18 years to his retirement, spending much of his spare time working for the good of the Bank.

Howard is still actively using his knowledge of the building industry in working with Matthew & Hockley Associates, inspecting some of their projects. At 87, he continues to enjoy hunting trips to the West and Alaska, adding to his already sizeable trophy collection. The Board and management of JBT recognize Howard Neuin's many contributions to the organization and wish him a long and enjoyable retirement.

## **Howard M. Neuin**

Director Emeritus;  
Director 1981-2009;  
VP of the Board 1987-90;  
President 1990-2007;  
Retired contractor.





[www.bankjbt.com](http://www.bankjbt.com)

**NEW Northside Commons**

101 Northside Commons  
Palmyra, PA 17078  
717-838-2265

**Jonestown**

2 West Market Street  
P.O. Box 717  
Jonestown, PA 17038  
717-865-2112

Shareholder Relations  
717-865-4246

**Ebenezer**

1725 Route 72 North  
Lebanon, PA 17046  
717-274-5421

**Grantville**

10103 Jonestown Road  
P.O. Box 180  
Grantville, PA 17028  
717-469-0623

**Lebanon**

Route 422 & Bowman Street  
Lebanon, PA 17046  
717-273-0405

**Newmanstown**

25 East Main Street  
Newmanstown, PA 17073  
610-589-1234

**Cleona**

421 East Penn Avenue  
Cleona, PA 17042  
717-279-7655

**Quentin Road**

1765 Quentin Road  
Lebanon, PA 17042  
717-279-7720

**Palmyra**

2 East Main Street  
Palmyra, PA 17078  
717-641-0032

*This statement has not been reviewed, or confirmed for accuracy or relevance, by the Federal Deposit Insurance Corporation.*