



Table of Contents

2	Board of Directors and Executive Officers
3	Letter to Shareholders
4	Financial Highlights
5	Report of Independent Auditors
6	Balance Sheets
7	Statements of Income
8	Statements of Stockholders' Equity
9	Statements of Cash Flows
10	Notes to Financial Statements

Board of Directors



Richard J. Newmaster, Jr.
Chairman and President

Director since 2004;
Vice President,
Chief Financial Officer,
Lebanon Seaboard Corp.,
CPA



Jeffrey L. Bohn
Vice Chairman

Director since 1987;
Co-owner,
J.P. Donmoyer, Inc.



Edward L. Anspach
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



During the past year the economy and the stock market had their ups and downs, with both ending on a higher note than the previous year. At Jonestown Bank & Trust Co., we had a similar experience. Loan growth was minimal during the first quarter and stronger in the second and third quarters, tapering off in the fourth quarter. We finished the year with growth in assets of 4.6% and a strong net income of \$3,614,000 compared to \$2,650,000 the previous year, an increase of 35.9%.

Earnings per share were \$2.41 at year end 2010 vs. \$1.77 the previous year. This increase in net income was due in a large part to reduced charge-offs and provisions for loan losses. We saw a marked decrease in consumer loans charged off for 2010, and as a result, a 55% decrease in provision for loan losses in 2010. The loan loss reserve as of December 31, 2010, was 1.41% of total loans, compared to 1.71% for year end 2009. In recent months the local economy has shown some strengthening. Last year we reported that the unemployment rate in Lebanon County was 7.0%. During 2010, it escalated to 7.9% and has since declined to 7.2% at year end. The surrounding counties, with the exception of Dauphin County, had similar changes.

Lynn R. Wenger
Chief Executive Officer



In addition, thanks to low rates during the year, mortgage refinancing generated an 85% increase in gains on sale of mortgages. The volume of mortgages we processed kept our staff busy through most of the year.

Net loans grew by 5.7%, with commercial loans increasing by 13.0%, mortgages by 3.3%, and installment loans flat. Deposits increased by 5.0%, led by a sizeable increase in money-market accounts, with small increases in checking and a small decrease in certificates of deposit. Our net interest margin increased slightly for the year, from 3.84% in 2009 to 3.89% at December 31, 2010.

Even with the economic downturn, our Northside Commons branch, which opened in February 2010, has done well, meeting our growth goals to date. We will continue to pursue other branching options going forward. That will require additional capital, so we take this opportunity to remind you that shareholders may increase their stake in Jonestown Bank & Trust Co. through our Dividend Reinvestment Plan (DRP). Shareholders in the plan may reinvest all or part of their dividends rather than taking them in cash, and may also purchase up to \$6,000 per quarter of new stock through the plan. A predetermined amount may also be set up for automatic debit from shareholders' deposit accounts each quarter. You may contact our agent, Registrar and Transfer, at Registrar and Transfer Company, Attn: Dividend Reinvestment Department, P. O. Box 664, 10 Commerce Drive, Cranford, NJ 07016-3572 or call 1-800-368-5948. You may also access an enrollment form on our web site, www.bankjbt.com, to sign up for the DRP.

In addition to the DRP enrollment form, we recently updated our web site with an Investor Relations section, which is available from the home page. Clicking on the Investor Relations tab will open a page where information on the last quarterly dividend is shown, the last annual and quarterly reports are available, and a Sellers List Authorization Form may be accessed and printed. If you have stock for sale, you may place your name on the Sellers List by downloading the authorization form and mailing it to the address printed there. You may also access a list

(continued)

Letter to Shareholders (continued)

of last known trades from the Investor Relations section. All these changes are designed to make more information available to our shareholders and potential shareholders. If you do not have access to a computer, please call Investor Relations at (717) 865-4246 for information on the Sellers List or if you have other questions.

We are pleased with this year's results, but look forward to an improving economy in 2011. We will continue to work toward better profits and an improved overall return for our shareholders. Thank you for your continued interest in Jonestown Bank & Trust Co.

Richard J. Newmaster, Jr.
Chairman and President

Lynn R. Wenger
Chief Executive Officer

Financial Highlights

(Dollars in thousands, except per share amounts)

	2010	2009	Change
Results of Operations			
Net Interest Income	\$ 12,369	\$ 11,613	6.5 %
Provision for Loan Losses	1,201	2,666	(55.0) %
Net Income	3,614	2,650	36.4 %
Per Share Data			
Basic Earnings	\$ 2.41	\$ 1.77	35.9 %
Cash Dividends	0.80	0.80	— %
Book Value	20.08	18.46	8.8 %
Financial Condition at Year-End			
Assets	\$ 349,354	\$ 333,861	4.6 %
Deposits	307,921	293,358	5.0 %
Loans Receivable, Net	289,458	273,734	5.7 %
Allowance for Loan Losses	4,132	4,776	(13.5) %
Stockholders' Equity	30,234	27,702	9.1 %
Financial Ratios			
Return on Average Assets	1.06 %	0.79 %	34.7 %
Return on Average Equity	12.35 %	9.82 %	25.8 %
Total Capital to Risk Weighted Assets	11.08 %	10.85 %	2.0 %



REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders
Jonestown Bank & Trust Co.

We have audited the accompanying balance sheet of Jonestown Bank & Trust Co. (the "Bank") as of December 31, 2010, and the related statements of income, stockholders' equity, and cash flows for the year 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. The financial statements of the Bank for the year ended December 31, 2009, were audited by other auditors whose report, dated February 9, 2010, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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, 2010, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

S. R. Snodgrass, A.C.

Wexford, PA
February 22, 2011

BALANCE SHEETS

<i>(Dollars in thousands, except per share amounts)</i>	December 31,	
	2010	2009
ASSETS		
Cash and due from banks	\$ 11,578	\$ 12,291
Time certificates of deposit	108	-
Securities available for sale	26,567	25,264
Securities held to maturity, fair value of \$2,652 and \$4,507	2,531	4,313
Loans held for sale	189	-
Loans	293,590	278,510
Less allowance for loan losses	4,132	4,776
Net loans	289,458	273,734
Restricted investment in bank stock	2,071	2,179
Foreclosed assets	1,306	1,107
Premises and equipment	3,219	2,903
Investment in life insurance	5,825	5,632
Prepaid federal deposit insurance	1,078	1,540
Accrued interest receivable and other assets	5,424	4,898
TOTAL ASSETS	\$ 349,354	\$ 333,861
LIABILITIES		
Deposits:		
Non-interest-bearing demand	\$ 29,039	\$ 26,491
Interest-bearing demand	278,882	266,867
Total deposits	307,921	293,358
Long-term debt	9,242	11,092
Accrued interest payable and other liabilities	1,957	1,709
TOTAL LIABILITIES	319,120	306,159
STOCKHOLDERS' EQUITY		
Preferred stock, without par value; 4,000,000 shares authorized at December 31, 2010 and none at December 31, 2009. No shares issued or outstanding at December 31, 2010 or 2009	-	-
Common stock, par value \$2.00; 6,000,000 and 3,000,000 shares authorized; issued and outstanding 1,505,905 and 1,500,123	3,012	3,000
Surplus	3,121	3,022
Retained earnings	23,833	21,420
Accumulated other comprehensive income	268	260
TOTAL STOCKHOLDERS' EQUITY	30,234	27,702
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 349,354	\$ 333,861

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

STATEMENTS OF INCOME

<i>(Dollars in thousands, except per share amounts)</i>	Year Ended December 31,	
	2010	2009
INTEREST INCOME		
Loans receivables, including fees	\$ 15,397	\$ 15,614
Securities:		
Taxable	691	947
Tax-exempt	391	268
Other	7	7
Total interest income	16,486	16,836
INTEREST EXPENSE		
Deposits	3,781	4,638
Short-term borrowings	2	46
Long-term debt	334	539
Total interest expense	4,117	5,223
NET INTEREST INCOME	12,369	11,613
Provision for loan losses	1,201	2,666
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,168	8,947
OTHER INCOME		
Trust income	255	230
Service charges on deposit accounts	1,356	1,399
Mortgage banking activities	593	339
Gain on sale of available-for-sale securities	-	49
Net gain on sale of foreclosed assets	134	102
Earnings on investment in life insurance	233	228
Other	480	422
Total other income	3,051	2,769
OTHER EXPENSE		
Salaries and employee benefits	4,667	3,937
Occupancy	728	570
Equipment and data processing	678	538
Marketing	272	261
ATM processing fees	355	307
Pennsylvania bank shares tax	273	216
Federal deposit insurance assessment	493	652
Other	1,697	1,566
Total other expense	9,163	8,047
Income before income taxes	5,056	3,669
Federal income taxes	1,442	1,019
NET INCOME	\$ 3,614	\$ 2,650
EARNINGS PER SHARE	\$ <u>2.41</u>	\$ <u>1.77</u>
WEIGHTED-AVERAGE SHARES OUTSTANDING	<u>1,501,982</u>	<u>1,500,580</u>

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

STATEMENTS OF STOCKHOLDERS' EQUITY

Years Ended December 31, 2010 and 2009						
<i>(Dollars in thousands, except per share amounts)</i>	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2008	\$ -	\$ 3,000	\$ 3,000	\$ 20,005	\$ (251)	25,754
Purchase and retirement of common stock (3,475 shares)	-	(7)	(51)	(35)	-	(93)
Issuance of common stock through dividend reinvestment plan (3,589 shares)	-	7	73	-	-	80
Comprehensive income:						
Net income	-	-	-	2,650	-	2,650
Other comprehensive income, net of taxes	-	-	-	-	511	511
Total comprehensive income						<u>3,161</u>
Cash dividends declared (\$0.80 per share)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,200)</u>	<u>-</u>	<u>(1,200)</u>
Balance, December 31, 2009	-	3,000	3,022	21,420	260	27,702
Issuance of common stock through dividend reinvestment plan (5,782 shares)	-	12	99	-	-	111
Comprehensive income:						
Net income	-	-	-	3,614	-	3,614
Other comprehensive income, net of taxes	-	-	-	-	8	8
Total comprehensive income						<u>3,622</u>
Cash dividends declared (\$.80 per share)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,201)</u>	<u>-</u>	<u>(1,201)</u>
Balance, December 31, 2010	<u>\$ -</u>	<u>\$ 3,012</u>	<u>\$ 3,121</u>	<u>\$ 23,833</u>	<u>\$ 268</u>	<u>\$ 30,234</u>

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

STATEMENTS OF CASH FLOWS

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2010	2009
OPERATING ACTIVITIES		
Net income	\$ 3,614	\$ 2,650
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,201	2,666
Provision for depreciation and amortization	428	378
Net amortization of securities premiums and discounts	273	94
Net realized gain on sale of foreclosed assets	(134)	(102)
Net realized gain on sale of securities	-	(49)
Deferred income taxes	217	(595)
Proceeds from sales of loans	22,106	18,962
Gains on sales of loans	(523)	(283)
Loans originated for sale	(21,772)	(18,679)
Increase in investment in life insurance	(193)	(187)
(Increase) decrease in prepaid federal deposit insurance	462	(1,540)
Increase in accrued interest receivable and other assets	(898)	(285)
Decrease in accrued interest payable and other liabilities	239	(324)
Net cash provided by operating activities	5,020	2,706
INVESTING ACTIVITIES		
Proceeds from maturities and principal repayments of:		
Securities held to maturity	1,787	3,882
Securities available for sale	6,218	3,787
Proceeds from sale of available for sale securities	-	1,049
Purchase of securities available for sale	(7,768)	(10,317)
Net (increase) decrease in time certificates of deposit	(108)	388
Net increase in loans	(17,898)	(24,898)
Net (increase) decrease in restricted investment in bank stock	108	(137)
Purchases of premises and equipment	(635)	(521)
Proceeds from sale of foreclosed assets	940	520
Net cash used in investing activities	(17,356)	(26,247)
FINANCING ACTIVITIES		
Net increase in deposits	14,563	52,556
Net decrease in short-term borrowings	-	(15,787)
Proceeds from long-term debt	2,000	-
Repayment of long-term debt	(3,850)	(5,181)
Proceeds from issuance of common stock	111	80
Retirement of common stock	-	(93)
Dividends paid	(1,201)	(1,200)
Net cash provided by financing activities	11,623	30,375
Increase (decrease) in cash and cash equivalents	(713)	6,834
Cash and cash equivalents:		
Beginning balance	12,291	5,457
Ending balance	\$ 11,578	\$ 12,291
SUPPLEMENTAL INFORMATION:		
Cash paid during the year for:		
Interest	\$ 4,208	\$ 5,317
Income taxes	1,745	1,305
Noncash investing transactions:		
Loans transferred to foreclosed assets	\$ 837	\$ 1,495

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

**JONESTOWN BANK & TRUST CO.
NOTES TO FINANCIAL STATEMENTS**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of operations

The Jonestown Bank & Trust Co. (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 and 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, 2010, for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through February 22, 2011, 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, with original maturities of 90 days or less, 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.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities (Continued)

Securities are evaluated on a periodic basis to determine whether a decline in their value is other than temporary. For debt securities, management considers whether the present value of cash flow expected to be collected is less than the security's amortized cost basis (the difference defined as the credit loss), the magnitude and duration of the decline, the reasons underlying the decline and the Company's intent to sell the security or whether it is more likely than not that the Company would be required to sell the security before its anticipated recovery in market value, to determine whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, if the investor does not intend to sell the security, and it is more-likely-than-not that it will not be required to sell the security, before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings.

Restricted Investments in Bank Stock

Restricted investments in bank stock, which represent required investments in the common stock of correspondent banks, are carried at cost and as of December 31, 2010 and 2009, consist of the common stock of the 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. As of December 31, 2010 and 2009, the recorded investment in FHLB common stock is \$2,051,300 and \$2,159,000, respectively.

Management evaluates the restricted stock for impairment at last annually, or more frequently, if necessary. 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 with 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.

The Federal Home Loan Bank of Pittsburgh has incurred losses in the prior two years and has suspended the payment of dividends. The losses are primarily attributable to impairment of investment securities associated with the extreme economic conditions in place over the last two years. Management evaluated the stock and concluded that the stock was not impaired for the periods presented herein. More consideration was given to the long-term prospects for the Federal Home Loan Bank as opposed to the recent stress caused by the extreme economic conditions the world is facing. Management also considered that the Federal Home Loan Bank's regulatory capital ratios have increased from the prior year, liquidity appears adequate, and new shares of FHLB Stock continue to exchange hands at the \$100 par value.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2010 were \$189,000. There were no loans held for sale at December 31, 2009.

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.

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

Management establishes the allowance for loan losses based upon its evaluation of the pertinent factors underlying the types and quality of loans in the portfolio. Commercial loans and commercial real estate loans are reviewed on a regular basis with a focus on larger loans along with loans which have experienced past payment or financial deficiencies. Larger commercial loans and commercial real estate loans which are 90 days or more past due are selected for impairment testing in accordance with Generally Accepted Accounting Principles (GAAP). These loans are analyzed to determine if they are "impaired", which means that it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. All commercial loans that are delinquent 90 days and residential mortgage loans that are 120 days delinquent and are placed on nonaccrual status are classified on an individual basis. The remaining loans are evaluated and classified as groups of loans with similar risk characteristics. The Company allocates allowances based on the factors described below, which conform to the

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

Company's asset classification policy. In reviewing risk within the Bank's loan portfolio, management has determined there to be several different risk categories within the loan portfolio. The allowance for loan losses consists of amounts applicable to: (i) the commercial loan portfolio; (ii) the commercial real estate portfolio; (iii) the consumer loan portfolio; (iv) the loans secured by residential real estate portfolio. Factors considered in this process included general loan terms, collateral, and availability of historical data to support the analysis. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. Certain qualitative factors are then added to the historical allocation percentage to get the total factor to be applied to non classified loans. The following qualitative factors are analyzed:

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

The Company analyzes its loan portfolio each quarter to determine the appropriateness of its allowance for loan losses.

Loan Charge-off Policies

Consumer loans are generally fully or partially charged down to the fair value of collateral securing the asset when the loan is 120 days past due unless the loan is well secured and in the process of collection.

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 with 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.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 split-dollar 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. The expense related to the liability for future benefits of the Bank’s split-dollar bank owned life insurance was approximately \$23,000 and \$48,000 for the years ended December 31, 2010 and 2009, 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.

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.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the Statement of Income. The Company’s federal and state income tax returns for taxable years through 2006 have been closed for purposes of examination by the Internal Revenue Service and the Pennsylvania Department of Revenue.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

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

<i>(Dollars in 000s)</i>	Years Ended December 31,	
	2010	2009
Unrealized gains (losses) on securities:		
Unrealized holding gains arising during the year	\$ 15	\$ 633
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	16	43
Net unrealized gains	31	627
Defined benefit pension plan:		
Prior service cost	(45)	(45)
Net loss	26	192
Other comprehensive income before tax	12	774
Tax effect	(5)	(263)
Other comprehensive income	\$ 7	\$ 511

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

<i>(Dollars in 000s)</i>	December 31,	
	2010	2009
Unrealized gains on securities available for sale	\$ 472	\$ 462
Unamortized unrealized losses on securities held to maturity	(11)	(21)
Unrecognized pension costs	(193)	(181)
Total accumulated other comprehensive income	\$ 268	\$ 260

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 were \$250,000 for each of the years ended December 31, 2010 and 2009.

3. SECURITIES

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

December 31, 2010						
<i>(Dollars in 000s)</i>	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses	Fair Value
Available-for-sale securities:						
Obligations of states and political subdivisions	\$	10,275	\$	93	\$ (24)	\$ 10,344
Mortgage-backed securities		15,576		652	(5)	16,223
Total	\$	25,851	\$	745	\$ (29)	\$ 26,567
Held-to-maturity securities:						
Obligations of states and political subdivisions	\$	300	\$	1	\$ -	\$ 301
Mortgage-backed securities		2,231		125	(5)	2,351
Total	\$	2,531	\$	126	\$ (5)	\$ 2,652
December 31, 2009						
<i>(Dollars in 000s)</i>	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses	Fair Value
Available-for-sale securities:						
Obligations of states and political subdivisions	\$	8,062	\$	130	\$ (4)	\$ 8,188
Mortgage-backed securities		16,502		579	(5)	17,076
Total	\$	24,564	\$	709	\$ (9)	\$ 25,264
Held-to-maturity securities:						
Obligations of states and political subdivisions	\$	500	\$	2	\$ -	\$ 502
Mortgage-backed securities		3,813		196	(4)	4,005
Total	\$	4,313	\$	198	\$ (4)	\$ 4,507

3. SECURITIES (Continued)

Securities with a fair value of \$13,307,000 and \$11,695,000 at December 31, 2010 and 2009, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

No securities were sold in 2010. Two securities were sold in 2009 resulting in a gain of \$49,000 and proceeds of \$1,049,000.

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, 2010, \$11,000 of this difference, net of taxes of \$5,000, 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, 2010 <i>(Dollars in 000s)</i>	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due after one year through five years	\$ 435	\$ 437	\$ 300	\$ 301
Due after five years through ten years	2,740	2,767	-	-
Due after ten years	7,716	7,751	-	-
Mortgage-backed securities	14,960	15,612	2,231	2,351
Total	\$ 25,851	\$ 26,567	\$ 2,531	\$ 2,652

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, 2010 and 2009.

December 31, 2010 <i>(Dollars in 000s)</i>	Less Than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available-for-sale securities:						
Obligations of states and political subdivisions	\$ 2,040	\$ (24)	\$ -	\$ -	\$ 2,040	\$ (24)
Mortgage-backed securities	533	(5)	-	-	533	(5)
	2,573	(29)	-	-	2,573	(29)
Held-to-maturity securities:						
Mortgage-backed securities	-	-	19	(5)	19	(5)
Total	\$ 2,573	\$ (29)	\$ 19	\$ (5)	\$ 2,592	\$ (34)

3. SECURITIES (Continued)

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

In management's opinion, the unrealized losses reflect changes in interest rates subsequent to the acquisition of specific securities. At December 31, 2010, the Bank had eight securities in an unrealized loss position. 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. In addition, management feels that these losses are the result of interest rate changes that are not expected to result in the non-collection of principal and interest during the period.

4. LOANS RECEIVABLE

Loans receivable consist of the following:

<i>(Dollars in 000s)</i>	December 31,	
	2010	2009
Real estate:		
Secured by residential real estate	\$ 102,098	\$ 105,796
Commercial	62,801	53,983
Commercial	15,863	13,050
Consumer	76,863	77,551
Home equity lines of credit	34,856	27,024
	292,481	277,404
Less allowance for loan losses	(4,132)	(4,776)
Net deferred costs	1,109	1,106
Net loans	\$ 289,458	\$ 273,734

5. ALLOWANCE FOR LOAN LOSSES

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

5. ALLOWANCE FOR LOAN LOSSES (Continued)

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

These qualitative factors are reviewed each quarter and adjusted based upon relevant changes within the portfolio. During 2010, the qualitative factors for changes in levels of and trends in loan review ratings were increased for all loan segments. Changes in portfolio volumes during 2010 resulted in a reduction to the related factors for consumer loans while it increased for commercial loans and commercial real estate segments. The qualitative factor was increased for trends in credit-quality rating for the loans rated substandard. The qualitative factor for changes in management/staff risk was decreased in 2010.

	<u>2010</u>	<u>2009</u>
Balance, January 1	\$ 4,776	\$ 3,087
Add:		
Provision charged to operations	1,201	2,666
Recoveries	457	358
Less loans charged off	<u>2,302</u>	<u>1,335</u>
Balance, December 31	<u>\$ 4,132</u>	<u>\$ 4,776</u>

Loans by Segment

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of \$4.1 million adequate to cover loan losses inherent in the loan portfolio, at December 31, 2010. The following table presents by portfolio segment the recorded investment in loans for the years ended December 31:

As of December 31, 2010						
<i>(Dollars in 000s)</i>	Commercial	Commercial Real Estate	Secured by Residential Real Estate	Consumer	Unallocated	Total
Allowance for credit losses:						
Ending Balance	\$ 180	\$ 700	\$ 1,433	\$ 1,715	\$ 104	\$ 4,132
Ending balance: individually evaluated for impairment	\$ -	\$ 77	\$ 37	\$ 23	\$ -	\$ 137
Ending balance: collectively evaluated for impairment	\$ 180	\$ 623	\$ 1,396	\$ 1,692	\$ 104	\$ 3,995
Financing Receivables:						
Ending Balance, net of fees	\$ 16,054	\$ 62,801	\$ 136,883	\$ 77,852	\$ -	\$ 293,590
Ending balance: individually evaluated for impairment	\$ -	\$ 4,225	\$ 1,329	\$ 110	\$ -	\$ 5,664
Ending balance: collectively evaluated for impairment	\$ 16,054	\$ 58,576	\$ 135,554	\$ 77,742	\$ -	\$ 287,926

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Information

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

The Company's internally assigned grades are as follows:

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

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

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

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

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

As of December 31, 2010				
<i>(Dollars in 000s)</i>	Commercial	Commercial Real Estate	Commercial Real Estate	Construction
Pass	\$ 15,857	\$ 48,490	\$ 5,427	
Special Mention	193	2,003	2,711	
Substandard	4	3,286	884	
Doubtful	-	-	-	
Loss	-	-	-	
Ending Balance	\$ 16,054	\$ 53,779	\$ 9,022	

As of December 31, 2010			
<i>(Dollars in 000s)</i>	Home Equity Lines of Credit	Secured by Residential Real Estate	
Pass	\$ 33,152	\$ 91,927	
Special Mention	1,636	7,356	
Substandard	68	2,744	
Doubtful	-	-	
Loss	-	-	
Ending Balance	\$ 34,856	\$ 102,027	

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

5. ALLOWANCE FOR LOAN LOSSES (Continued)

As of December 31, 2010			
<i>(Dollars in 000s)</i>		Indirect Automobile Financing	Other Consumer Loans
Performing	\$	66,183	\$ 11,600
Non-Performing		68	1
Total	\$	66,251	\$ 11,601

Following is a table which includes an aging analysis of the recorded investment of past due financing receivables.

As of December 31, 2010								
<i>(Dollars in 000s)</i>	30-59 Days Past Due	60-89 Days Past Due	90 Days Or Greater	Total Past Due	Current	Total Financing Receivables	> 90 Days and Accruing	
Commercial	\$ 1	\$ 10	\$ -	\$ 11	\$ 16,043	\$ 16,054	\$ -	-
Commercial real estate	112	-	2,536	2,648	51,131	53,779	-	-
Commercial real estate construction	-	-	1,526	1,526	7,496	9,022	-	-
Home equity lines of credit	10	40	58	108	34,748	34,856	-	-
Secured by residential real estate	1,832	503	1,772	4,107	97,920	102,027	-	-
Consumer - indirect automobile financing	736	205	68	1,009	65,241	66,250	69	69
Consumer - other	-	-	1	1	11,599	11,600	-	-
Total	\$ 2,691	\$ 758	\$ 5,961	\$ 9,410	\$ 284,178	\$ 293,588	\$ 69	69

Impaired Loans

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

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable.

5. ALLOWANCE FOR LOAN LOSSES (Continued)

The following table includes the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable.

As of and for the year ended December 31, 2010					
<i>(Dollars in 000s)</i>	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	845	865	-	624	14
Commercial real estate construction	1,580	1,580	-	1,610	-
Home equity lines of credit	-	-	-	-	-
Secured by residential real estate	473	473	-	479	1
Consumer - indirect automobile financing	-	-	-	-	-
Consumer - other	-	-	-	-	-
With an allowance recorded:					
Commercial	-	-	-	-	-
Commercial real estate	1,800	2,729	77	2,360	-
Commercial real estate construction	-	-	-	-	-
Home equity lines of credit	-	-	-	-	-
Secured by residential real estate	856	1,047	37	808	7
Consumer - indirect automobile financing	-	-	-	-	-
Consumer - other	110	110	23	28	9
Total	\$ 5,664	\$ 6,804	\$ 137	\$ 5,909	\$ 31

Nonaccrual Loans

Commercial Loans are considered nonaccrual upon 90 days delinquency and, residential loans are placed on nonaccrual after 120 days. When a loan is placed in nonaccrual status, previously accrued but unpaid interest is deducted from interest income.

During 2009, the Bank had nonaccrual loans of approximately \$4,940,000.

On the following table are the financing receivables on nonaccrual status as of December 31, 2010. The balances are presented by class of financing receivable.

<i>(Dollars in 000s)</i>	As of December 31, 2010
Commercial	\$ -
Commercial real estate	2,536
Commercial real estate construction	1,526
Home equity lines of credit	58
Secured by residential real estate	2,502
Consumer - indirect automobile financing	-
Consumer - other	-
Total	\$ 6,622

6. MORTGAGE SERVICING

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 \$108,356,000 and \$86,727,000 as of December 31, 2010 and 2009, respectively. The agreements include a maximum credit enhancement of \$1,895,000, 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 percent 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 percent 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 \$60,101,000 and \$47,057,000 at December 31, 2010 and 2009, 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 \$314,000 at December 31, 2010, and \$225,000 at December 31, 2009.

The following summarizes mortgage servicing rights capitalized and amortized:

<i>(Dollars in 000s)</i>	Years Ended December 31,	
	2010	2009
Mortgage servicing rights capitalized	\$ 172	\$ 141
Mortgage servicing rights amortized	83	94
Net Change	\$ 89	\$ 47

7. BANK PREMISES AND EQUIPMENT

Components of Bank premises and equipment are as follows:

<i>(Dollars in 000s)</i>	December 31,	
	2010	2009
Land and improvements	\$ 456	\$ 456
Buildings	4,482	4,080
Furniture and equipment	2,964	2,730
Total premises and equipment	7,902	7,266
Less accumulated depreciation	(4,683)	(4,363)
Net premises and equipment	\$ 3,219	\$ 2,903

Depreciation expense for the years ended December 31, 2010 and 2009 was approximately \$428,000 and \$378,000, respectively.

7. BANK PREMISES AND EQUIPMENT (Continued)

The Bank leases land and office space under operating leases. Rental expense, including real estate taxes, for these leases was \$176,000 and \$93,000 for the years ended December 31, 2010 and 2009, respectively. Future minimum rental commitments under these leases are as follows:

<i>(Dollars in 000s)</i>	Years Ending December 31,	
2011	\$	131
2012		131
2013		135
2014		138
2015		146
Thereafter		1,595
Total	\$	2,276

8. DEPOSITS

The composition of deposits is as follows:

<i>(Dollars in 000s)</i>	December 31,	
	2010	2009
Demand, non-interest-bearing	\$ 29,039	\$ 26,491
Checking with interest and money market	112,527	102,262
Savings	21,931	20,721
Time deposits of \$100,000 or more	56,276	47,838
Other time deposits	88,148	96,046
Total	\$ 307,921	\$ 293,358

At December 31, 2010, the scheduled maturities of time deposits are as follows:

<i>(Dollars in 000s)</i>	Years Ended December 31,	
2011	\$	85,493
2012		22,769
2013		15,189
2014		17,215
2015		3,758
Thereafter		-
Total	\$	144,424

9. 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 percent 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 percent up to 4 percent of compensation. The Bank's contributions to this plan were \$101,000 in 2010 and \$95,000 in 2009.

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.

9. EMPLOYEE BENEFITS (Continued)

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, 2010 and 2009.

<i>(Dollars in 000s)</i>	December 31,	
	2010	2009
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 2,333	\$ 2,178
Service cost	222	220
Interest cost	138	127
Actuarial (gain) loss	125	(32)
Experience (gain) loss	(23)	26
Benefits paid	(92)	(186)
Benefit obligation at end of year	2,703	2,333
Change in plan assets		
Fair value of plan assets at beginning of year	1,752	1,463
Employer contribution	225	225
Actual return on plan assets	231	250
Benefits paid	(92)	(186)
Fair value of plan assets at end of year	2,116	1,752
Funded status	\$ (587)	\$ (581)
Amounts recognized in accumulated other comprehensive income (loss) consist of:		
Net loss	\$ 538	\$ 564
Prior service cost	(244)	(289)
Total	\$ 294	\$ 275

Net periodic pension expense included the following components:

<i>(Dollars in 000s)</i>	Years Ended December 31,	
	2010	2009
Service cost	\$ 222	\$ 220
Interest cost	138	127
Expected return on plan assets	(129)	(106)
Net amortization and deferral	(18)	(3)
Net periodic pension expense	\$ 213	\$ 238

The accumulated benefit obligation was \$2,379,000 and \$2,333,000 at December 31, 2010 and 2009, respectively.

9. EMPLOYEE BENEFITS (Continued)

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

	December 31,	
	2010	2009
Discount rate	5.58 %	5.96 %
Expected long-term return on Plan assets	7.00	7.00
Rate of compensation increase	3.75	4.50

The selected long-term rate of return on Plan assets (7.0 percent) 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.

The Bank's pension plan asset allocations, by asset category, are as follows:

	December 31,	
	2010	2009
Equities	59 %	60 %
Fixed income	35	38
Other	6	2
Total	100 %	100 %

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value:

	As of December 31, 2010			
<i>(Dollars in 000s)</i>	Level I	Level II	Level III	Total
Assets:				
Equities	\$ 1,243	\$ -	\$ -	\$ 1,243
Fixed Income	748	-	-	748
Other	125	-	-	125
Total assets at fair value	\$ 2,116	\$ -	\$ -	\$ 2,116

	As of December 31, 2009			
<i>(Dollars in 000s)</i>	Level I	Level II	Level III	Total
Assets:				
Equities	\$ 1,051	\$ -	\$ -	\$ 1,051
Fixed Income	666	-	-	666
Other	35	-	-	35
Total assets at fair value	\$ 1,752	\$ -	\$ -	\$ 1,752

The Bank expects to contribute \$225,000 to its pension plan in 2011.

9. EMPLOYEE BENEFITS (Continued)

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

<i>(Dollars in 000s)</i>	Year Ended December 31,	
2011	\$	31
2012		31
2013		66
2014		71
2015		95
2016 - 2020		559
	\$	853

10. INCOME TAXES

The provision for federal income taxes consisted of the following:

<i>(Dollars in 000s)</i>	Years Ended December 31,	
	2010	2009
Current	\$ 1,225	\$ 1,614
Deferred	217	(595)
Total	\$ 1,442	\$ 1,019

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

<i>(Dollars in 000s)</i>	Years Ended December 31,			
	2010		2009	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Provision at statutory rate	\$ 1,719	34.0 %	\$ 1,248	34.0 %
Tax exempt interest, net	(223)	(4.4)	(183)	(5.0)
Life insurance	(57)	(1.1)	(47)	(1.3)
Other, net	3	-	1	0.1
Actual tax expense and effective rate	\$ 1,442	28.5 %	\$ 1,019	27.8 %

10. INCOME TAXES (Continued)

Net deferred tax assets consisted of the following components.

<i>(Dollars in 000s)</i>	As of December 31,	
	2010	2009
Deferred tax assets:		
Allowance for loan losses	\$ 1,108	\$ 1,426
Accrued pension	100	105
Other pension adjustments	100	94
Other	93	5
Total deferred tax assets	1,401	1,630
Deferred tax liabilities:		
Net unrealized gain on securities	(237)	(227)
Premises and equipment	(202)	(215)
Mortgage servicing rights	(107)	(76)
Securities accretion	(32)	(36)
Prepaid expenses	(74)	(87)
Other	-	(18)
Total deferred tax liabilities	(652)	(659)
Net deferred tax assets	\$ 749	\$ 971

11. BORROWED FUNDS

The Bank has available a \$25 million line with the Federal Home Loan Bank of Pittsburgh (FHLB). This line expires in February 2012. The interest rate on this line was 0.65 percent at December 31, 2010, and 0.62 percent at December 31, 2009. There was no outstanding balance under this line at December 31, 2010 and 2009.

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

<i>(Dollars in 000s)</i>	Rate	December 31,	
		2010	2009
January 2010	3.68 %	\$ -	\$ 3,000
January 2011	3.77	2,000	2,000
August 2013	4.10	1,881	2,535
October 2013	1.10	1,000	-
October 2015	1.82	1,000	-
May 2023	4.57	2,182	2,309
May 2023	4.68	1,179	1,248
		\$ 9,242	\$ 11,092

The contractual maturities of long-term debt at December 31, 2010, are:

<i>(Dollars in 000s)</i>	
2011	\$ 2,000
2012	-
2013	2,881
2014	-
2015	1,000
Thereafter	3,361
Total	\$ 9,242

11. BORROWED FUNDS (Continued)

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 \$125 million at December 31, 2010, of which \$9.2 million is outstanding.

12. SHORT-TERM BORROWINGS

The following table represents the activity related to the bank's short-term borrowings:

<i>(Dollars in 000s)</i>	As of and for the Years Ended December 31,			
	2010		2009	
Balance at year-end	\$	-	\$	-
Average balance outstanding during the year		291		6,484
Maximum amount outstanding at any month-end		8,655		20,158
Weighted-average interest rate:				
As of year-end		- %		- %
Paid during the year		0.69 %		0.71 %

13. 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, 2010 and 2009, these persons were indebted to the Bank for loans totaling \$1,971,000 and \$1,816,000, respectively. During 2010, \$408,000 of new loans were made and repayments totaled \$254,000.

14. 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.

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 creditworthiness 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.

14. OFF-BALANCE SHEET COMMITMENTS (Continued)

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 12 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, 2010 and 2009, 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 000s)</i>	December 31,	
	2010	2009
Commitments to extend credit	\$ 2,433	\$ 8,063
Unfunded commitments	37,823	33,070
Standby letters of credit	7,841	8,727
Total	\$ 48,097	\$ 49,860

15. 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.

16. 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 and 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 I capital (as defined in the regulations) to risk-weighted assets and of Tier I capital to average assets. Management believes, as of December 31, 2010, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2010, 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.

16. REGULATORY MATTERS (Continued)

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

<i>(Dollars in 000s)</i>	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	≥ Amount	≥ Ratio	≥ Amount	≥ Ratio
Total Capital (to risk-weighted assets)						
2010	\$ 33,743	11.08 %	\$ 24,373	8.00 %	\$ 30,467	10.00 %
2009	\$ 31,009	10.85 %	\$ 22,864	8.00 %	\$ 28,580	10.00
Tier I Capital (to risk-weighted assets)						
2010	\$ 29,918	9.82 %	\$ 12,187	4.00 %	\$ 18,280	6.00 %
2009	\$ 27,408	9.61 %	\$ 11,432	4.00 %	\$ 17,148	6.00
Tier I Capital (to average assets)						
2010	\$ 29,927	8.61 %	\$ 13,903	4.00 %	\$ 17,379	5.00 %
2009	\$ 27,411	8.26 %	\$ 13,274	4.00 %	\$ 16,593	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, 2010, \$23,841,000 of retained earnings was available for dividend declaration without prior regulatory approval, subject to the above regulatory capital requirements.

17. FAIR VALUE

Management has established 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 I measurements) and the lowest priority to unobservable inputs (Level III measurements). The three levels of the fair value hierarchy are as follows:

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

17. FAIR VALUE (Continued)

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, 2010 and 2009, are as follows:

As of December 31, 2010				
<i>(Dollars in 000s)</i>	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Available for sale securities:				
Obligations of states and political subdivisions	\$ -	\$ 10,344	\$ -	\$ 10,344
Mortgage-backed securities	-	16,223	-	16,223
Total	\$ -	\$ 26,567	\$ -	\$ 26,567

As of December 31, 2009				
<i>(Dollars in 000s)</i>	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
Available for sale securities:				
Obligations of states and political subdivisions	\$ -	\$ 8,188	\$ -	\$ 8,188
Mortgage-backed securities	-	17,076	-	17,076
Total	\$ -	\$ 25,264	\$ -	\$ 25,264

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, 2010 and 2009, are as follows:

As of December 31, 2010				
<i>(Dollars in 000s)</i>	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	\$ -	\$ 5,527	\$ -	\$ 5,527
Other real estate owned	-	1,087	65	1,152
Total	\$ -	\$ 6,614	\$ 65	\$ 6,679

As of December 31, 2009				
<i>(Dollars in 000s)</i>	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	\$ -	\$ 3,692	\$ -	\$ 3,692
Other real estate owned	-	987	-	987
Total	\$ -	\$ 4,679	\$ -	\$ 4,679

18. FAIR VALUES OF FINANCIAL INSTRUMENTS

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, 2010 and 2009.

18. FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

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 available for sale and held to maturity

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.

Loans held for sale

The carrying amount of loans held for sale approximates its fair value.

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 II 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 \$5,664,573 less their specific valuation allowances of \$137,428.

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.

Deposits

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.

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.

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.

18. FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The estimated fair values of the Bank's financial instruments were as follows at December 31, 2010 and 2009.

	As of December 31,			
	2010		2009	
<i>(Dollars in 000s)</i>	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and due from banks	\$ 11,578	\$ 11,578	\$ 12,291	\$ 12,291
Time certificates of deposit	108	108	-	-
Available for sale securities	26,567	26,567	25,264	25,264
Held to maturity securities	2,531	2,652	4,313	4,507
Loans held for sale	189	189	-	-
Net loans	289,458	304,572	273,734	290,442
Accrued interest receivable	3,024	3,024	2,987	2,987
Restricted investment in Bank stock	2,071	2,071	2,179	2,179
Mortgage servicing rights	314	409	224	224
Financial liabilities:				
Deposits	\$ 307,921	\$ 310,252	\$ 293,358	\$ 295,732
Long-term debt	9,242	9,607	11,092	11,578
Accrued interest payable	236	236	327	327
Off-balance sheet financial instruments:				
Commitments to extend credit	-	-	-	-
Stand by letters of credit	-	-	-	-

19. 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.



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