ORRSTOWN FINANCIAL SERVICES INC
Form 10-Q
August 05, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2010

Or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______.

Commission File Number 001-34292

ORRSTOWN FINANCIAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

Commonwealth of Pennsylvania	**23-2530374**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

77 East King Street, P.O. Box 250, Shippensburg, Pennsylvania	**17257**
(Address of principal executive offices)	**(Zip Code)**

(717) 532-6114

(Registrant s telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer: and smaller reporting company in Rule 12b 2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell Corporation (as defined in Rule 12b 2 of the Exchange Act). YES ¨ NO x

As of June 30, 2010, 7,970,559 shares of common stock, no par value, of the registrant were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)	**(Unaudited) June 30, 2010**	**(Audited) * December 31, 2009**
ASSETS		
Cash and due from banks	$ 17,838	$ 13,940
Federal funds sold	20,705	8,000
Cash and cash equivalents	38,543	21,940
Short-term investments	6,247	6,388
Interest bearing deposits with banks	0	601
Member stock, at cost which approximates market value	8,056	8,056
Securities available for sale	327,907	196,253
Loans	898,128	881,074
Allowance for loan losses	(14,582)	(11,067)
Net Loans	883,546	870,007
Premises and equipment, net	28,566	29,601
Goodwill and intangible assets	20,808	20,938
Cash surrender value of life insurance	22,312	21,204
Accrued interest receivable	4,762	4,605
Other assets	18,009	16,839
Total assets	$ 1,358,756	$ 1,196,432
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Non-interest bearing	$ 102,725	$ 90,676
Interest bearing	986,825	824,494
Total deposits	1,089,550	915,170
Short-term borrowings	45,367	97,914
Long-term debt	57,132	64,858
Accrued interest payable	899	1,040
Other liabilities	7,905	6,564
Total liabilities	1,200,853	1,085,546
Common stock, no par value - $ .05205 stated value per share; 50,000,000 shares authorized; 7,972,398 and 6,469,508 shares issued	415	337
Additional paid-in capital	120,814	82,895
Retained earnings	32,999	28,857
Accumulated other comprehensive income (loss)	3,728	(501)

Treasury stock, 1,839 and 26,313 shares, at cost	(53)	(702)
Total shareholders equity	157,903	110,886
Total liabilities and shareholders equity	$ 1,358,756	$ 1,196,432

* Condensed from audited financial statements

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

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ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in Thousands)	Three Months Ended June 2010	June 2009
INTEREST INCOME		
Interest and fees on loans	$ 12,205	$ 11,787
Interest and dividends on investment securities	2,298	1,342
Interest on short-term investments	33	13
Total interest income	14,536	13,142
INTEREST EXPENSE		
Interest on deposits	2,747	3,265
Interest on short-term borrowings	81	96
Interest on long-term debt	408	969
Total interest expense	3,236	4,330
Net interest income	11,300	8,812
Provision for loan losses	5,000	300
Net interest income after provision for loan losses	6,300	8,512
OTHER INCOME		
Service charges on deposits	1,881	1,750
Other service charges	1,451	1,130
Trust department income	834	637
Brokerage income	440	350
Other income	1,301	190
Securities gains	1,781	293
Total other income	7,688	4,350
OTHER EXPENSES		
Salaries and employee benefits	4,716	4,268
Occupancy and equipment	1,186	1,176
Data processing	309	283
Advertising	100	113
Other operating expense	2,413	2,504
Total other expense	8,724	8,344
Income before income taxes	5,264	4,518
Income tax expense	1,360	1,064
Net income	$ 3,904	$ 3,454

PER SHARE DATA		
Basic earnings per share	$ 0.49	$ 0.54
Diluted earnings per share	$ 0.47	$ 0.51
Dividends per share	$ 0.22	$ 0.22

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

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ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Dollars in Thousands)	Six Months Ended June 2010	Six Months Ended June 2009
INTEREST INCOME		
Interest and fees on loans	$ 24,044	$ 23,202
Interest and dividends on investment securities	4,212	2,484
Interest on short term investments	63	33
Total interest income	28,319	25,719
INTEREST EXPENSE		
Interest on deposits	5,427	6,656
Interest on short-term borrowings	245	181
Interest on long-term debt	850	2,048
Total interest expense	6,522	8,885
Net interest income	21,797	16,834
Provision for loan losses	6,420	515
Net interest income after provision for loan losses	15,377	16,319
OTHER INCOME		
Service charges on deposits	3,577	3,261
Other service charges	2,330	2,177
Trust department income	1,530	1,286
Brokerage income	838	635
Other income	1,707	502
Securities gains	2,179	458
Total other income	12,161	8,319
OTHER EXPENSES		
Salaries and employee benefits	9,548	8,539
Occupancy and equipment	2,389	2,390
Data processing	603	530
Advertising	191	226
Security impairment expense	0	36
Other operating expense	4,779	4,300
Total other expense	17,510	16,021
Income before income taxes	10,028	8,617
Income tax expense	2,718	2,138
Net income	$ 7,310	$ 6,479

PER SHARE DATA				
Basic earnings per share	$	1.01	$	1.01
Diluted earnings per share	$	0.97	$	0.96
Dividends per share	$	0.44	$	0.44

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

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ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

	Six Months Ended June 30, 2010 and 2009					
(Dollars in thousands)	**Common Stock**	**Additional Paid-In Capital**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Treasury Stock**	**Total Shareholders Equity**
Beginning Balance, January 1, 2009	$ 336	$ 82,555	$ 21,120	$ 1,369	($ 2,033)	$ 103,347
Comprehensive income						
Net income	0	0	6,479	0	0	6,479
Net unrealized securities gains	0	0	0	170	0	170
Net unrealized losses on derivatives	0	0	0	(1,086)	0	(1,086)
Comprehensive income						5,563
Cash dividends ($.44 per share)	0	0	(2,811)	0	0	(2,811)
Stock-based compensation plans:						
Compensation expense	0	24	0	0	0	24
Issuance of stock	1	240	0	0	0	241
Issuance of treasury stock (3,042 shares)	0	(42)	0	0	103	61
Balance, June 30, 2009	$ 337	$ 82,777	$ 24,788	$ 453	($ 1,930)	$ 106,425
Beginning Balance, January 1, 2010	$ 337	$ 82,895	$ 28,857	($ 501)	($ 702)	$ 110,886
Comprehensive income						
Net income	0	0	7,310	0	0	7,310
Net unrealized securities gains	0	0	0	3,594	0	3,594
Net unrealized gains on derivatives	0	0	0	635	0	635
Comprehensive income						11,539
Cash dividends ($.44 per share)	0	0	(3,168)	0	0	(3,168)
Stock-based compensation plans:						
Compensation expense	0	27	0	0	0	27
Issuance of stock	0	150	0	0	0	150
Issuance of stock through dividend reinvestment plan	1	331	0	0	0	332
Issuance of treasury stock (24,474 shares)	0	(62)	0	0	649	587
Issuance of common stock (1,481,481 shares)	77	37,473	0	0	0	37,550
Balance, June 30, 2010	$ 415	$ 120,814	$ 32,999	$ 3,728	($ 53)	$ 157,903

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

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ORRSTOWN FINANCIAL SERVICES, INC. AND ITS WHOLLY-OWNED SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended	
(Dollars in Thousands)	**June 2010**	**June 2009**
COMPREHENSIVE INCOME		
Net Income	$ 3,904	$ 3,454
Other comprehensive income, net of tax		
Unrealized gain on investment securities available for sale	2,913	7
Unrealized gain (loss) on rate swaps	231	(1,059)
Comprehensive Income	$ 7,048	$ 2,402

	Six Months Ended	
(Dollars in Thousands)	**June 2010**	**June 2009**
COMPREHENSIVE INCOME		
Net Income	$ 7,310	$ 6,479
Other comprehensive income, net of tax		
Unrealized gain on investment securities available for sale	3,594	170
Unrealized gain (loss) on rate swaps	635	(1,086)
Comprehensive Income	$ 11,539	$ 5,563

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

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ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in Thousands)	Six Months Ended June 2010	Six Months Ended June 2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 7,310	$ 6,479
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,431	1,714
Provision for loan losses	6,420	515
Net loss on disposal of other real estate owned	16	9
Net (gain) on disposal of bank premises and equipment	(119)	0
Net (gain) on sale of rate swap	(778)	0
Investment securities (gains)	(2,179)	(458)
Securities impairment loss	0	36
Other, net	(1,732)	(2,000)
Net cash provided by operating activities	11,369	6,295
CASH FLOWS FROM INVESTING ACTIVITIES		
Net decrease (increase) in interest bearing deposits with banks and short term investments	742	(268)
Purchases of available for sale securities	(307,424)	(98,703)
Sales and maturities of available for sale securities	182,432	54,844
Proceeds from disposal of other real estate owned	225	417
Proceeds from disposal of bank premises and equipment	373	0
Proceeds from sale of rate swap	868	0
Net (increase) in loans	(20,398)	(26,011)
Purchases of bank premises and equipment	(317)	(201)
Other, net	(825)	(1,199)
Net cash (used) by investing activities	(144,324)	(71,121)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	174,380	51,754
Dividends paid	(3,168)	(2,811)
Net proceeds from issuance of common stock	38,032	241
Net proceeds from issuance of treasury stock	587	61
Net change in short-term borrowings	(52,547)	20,392
Repayment of long-term borrowings	(7,726)	(13,220)
Net cash provided by financing activities	149,558	56,417
Net increase (decrease) in cash and cash equivalents	16,603	(8,409)
Cash and cash equivalents at beginning of period	21,940	26,804
Cash and cash equivalents at end of period	$ 38,543	$ 18,395
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		

Interest	$ 6,663	$ 8,728
Income Taxes	3,400	1,575
Supplemental schedule of noncash investing and financing activities:		
Unrealized gain on investments available for sale (net of deferred taxes of $1,935 and $92 at June 30, 2010 and 2009, respectively)	3,594	170
Unrealized gain (loss) on rate swaps (net of deferred taxes of $342 and ($585) at June 30, 2010 and 2009, respectively)	635	(1,086)
Other real estate acquired in settlement of loans	439	764

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

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ORRSTOWN FINANCIAL SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2010

Note 1: Summary of Significant Accounting Policies

Basis of Presentation

The unaudited financial statements of Orrstown Financial Services, Inc. (the Corporation) and its subsidiary are presented at and for the three and six months ended June 30, 2010 and 2009 and have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. However, unaudited information reflects all adjustments (consisting solely of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim period. Information presented at December 31, 2009 is condensed from audited year-end financial statements. For further information, refer to the audited consolidated financial statements and footnotes thereto, included in the annual report on Form 10-K for the year ended December 31, 2009.

Operating

Orrstown Financial Services, Inc. is a financial holding company including its wholly-owned subsidiary, Orrstown Bank. All significant intercompany transactions and accounts have been eliminated. Operating results for the three and six months ended June 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 relate to the determination of the allowance for losses on loans and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowance for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Corporation s allowance for losses on loans and foreclosed real estate. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments concerning information available to them at the time of their examination. Because of these factors, management s estimate of credit losses inherent in the loan portfolio and the related allowance may change in the near term.

Cash Flows

For purposes of the Statements of Cash Flows, cash and cash equivalents include Cash and due from banks and Federal funds sold. The Corporation has elected to present the net increase or decrease in deposits with banks, loans and deposits in the Statement of Cash Flows.

Federal Income Taxes

For financial reporting purposes, the provision for loan losses charged to operating expense is based on management s judgment, whereas for federal income tax purposes the amount allowable under present tax law is deducted. Additionally, deferred compensation is charged to operating expense in the period the liability is incurred for financial reporting purposes, whereas for federal income tax purposes these expenses are deducted when paid. As a result of the aforementioned timing differences plus the timing differences associated with depreciation expense, deferred income taxes are provided in the financial statements. Income tax expense is less than the amount calculated using the statutory tax rate primarily as a result of tax exempt income earned from state and political subdivision obligations and tax free loans.

Investment Securities

Under generally accepted accounting principles, the Corporation may segregate their investment portfolio into three specific categories: securities held to maturity , trading securities and securities available for sale . Securities held to maturity are to be accounted for at their amortized cost; securities classified as trading securities are to be accounted for at their current market value with unrealized gains and losses on such securities included in current period earnings; and securities classified as available for sale are to be accounted for at their current market value with unrealized gains and losses on such securities to be excluded from earnings and reported as a net amount in other comprehensive income.

Management determines the appropriate classification of securities at the time of purchase. If management has the intent and the Corporation has the ability, at the time of purchase, to hold securities until maturity, they are classified as securities held to maturity and carried at amortized historical cost. Securities to be held for indefinite periods of time and not intended to be held to maturity are classified as available for sale and carried at fair value. Securities held for indefinite periods of time include securities that management intends to use as part of its asset and liability management strategy and that may be sold in response to changes in interest rates, resultant prepayment risk and other factors related to interest rate and resultant prepayment risk changes.

The Corporation has classified all of its investment securities as available for sale . Short-term investments consist of certificates of deposits with banks.

Realized gains and losses on dispositions are based on the net proceeds and the adjusted book value of the securities sold, using the specific identification method. Unrealized holding gains and losses, net of tax, on securities available for sale are reported as a net amount in a separate component (accumulated other comprehensive income) of shareholders equity until realized. Other-than-temporary impairment (OTTI) loss is recognized in earnings through the income statement in the period in which OTTI loss is taken, except for the non-credit component of OTTI losses on debt securities, which are recognized in other comprehensive income. Purchase premiums and discounts are recognized in interest income over the terms of the securities using the interest method over the period to maturity.

The Corporation s investments are exposed to various risks, such as interest rate, market risk, currency and credit risks. Due to the level of risk associated with certain investments and the level of uncertainty related to changes in the value of investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment assets reported in the financial statements.

Stock-Based Compensation

The Corporation maintains two stock-based compensation plans. These plans provide for the granting of stock options to the Corporation s directors and the Bank s employees. Generally accepted accounting principles, Share-Based Payment requires financial statement recognition of compensation cost for stock options and other stock-based awards. Both of the Corporation s stock-based compensation plans are fully vested when granted and, therefore, are expensed on the date of grant using the Black-Scholes option-pricing model.

Earnings per Share of Common Stock

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect the addition of an incremental number of shares added as a result of converting common stock equivalents. A reconciliation of the weighted average shares outstanding used to calculate basic net income per share and diluted net income per share follows.

Earnings per share for the three and six months ended June 30 have been computed as follows:

	Three Months Ended		Six Months Ended	
(In Thousands, except per share data)	**June 2010**	**June 2009**	**June 2010**	**June 2009**
Net Income	$ 3,904	$ 3,454	$ 7,310	$ 6,479
Weighted average shares outstanding (basic)	7,962	6,392	7,233	6,389
Impact of common stock equivalents	308	338	315	337
Weighted average shares outstanding (diluted)	8,270	6,730	7,548	6,726
Per share information:				
Basic earnings per share	$ 0.49	$ 0.54	$ 1.01	$ 1.01

Diluted earnings per share	$ 0.47	$ 0.51	$ 0.97	$ 0.96

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Derivative Instruments and Hedging Activities

Generally accepted accounting principles require that all derivatives be recognized in the Consolidated Financial Statements at their fair values. On the dates that derivative contracts are entered into, the Corporation designates derivatives as (a) hedges of fair values of recognized assets or liabilities or of unrecognized firm commitments (fair-value hedges); (b) hedges of forecasted transactions or variable cash flows to be received or paid in conjunction with recognized assets or liabilities (cash-flow hedges) or (c) instruments that are held for trading or non-hedging purposes (trading or economic-hedging instruments). For a derivative treated as a fair-value hedge, the effective portion of a change in fair value is recorded as an adjustment to the hedged item. The ineffective portion of the fair-value hedge is recognized in current period earnings. Upon termination of a fair-value hedge of a debt instrument, the resulting gain or loss is amortized to earnings through the maturity date of the debt instrument. For a derivative treated as a cash flow hedge, the ineffective portion of changes in fair value is reported in current period earnings. The effective portion of the cash flow hedge is recorded as an adjustment to the hedged item through other comprehensive income. For a derivative treated as a trading or economic hedging instrument, changes in fair value are reported in current period earnings. Fair values are determined based upon quoted market prices and mathematical models using current and historical data.

The Corporation formally assesses, both at the hedges inception, and on an on-going basis, whether derivatives used in hedging transactions have been highly effective in offsetting changes in fair values or cash flows of hedged items and whether those derivatives are expected to remain highly effective in subsequent periods. The Corporation discontinues hedge accounting when (a) it determines that a derivative is no longer effective in offsetting changes in fair value or cash flows of a hedged item; (b) the derivative expires or is sold, terminated or exercised; (c) probability exists that the forecasted transaction will no longer occur or (d) management determines that designating the derivative as a hedging instrument is no longer appropriate. In all cases in which hedge accounting is discontinued and a derivative remains outstanding, the Corporation will carry the derivative at fair value in the Consolidated Financial Statements, recognizing changes in fair value in current period income in the statement of income.

The Corporation follows generally accepted accounting principles, Disclosures about Derivative Instruments and Hedging Activities , which includes the disclosure requirements for derivative instruments and hedging activities to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows.

The Bank entered into three (3) rate swap agreements - two on November 24, 2008, and one on May 22, 2009 - related to fixed rate loans. The Bank uses interest rate swaps to reduce interest rate risks and to manage interest income. By entering into these agreements, the Bank converts floating rate assets into fixed rate assets, or alternatively, converts fixed rate assets into floating rate assets. Interest differentials paid or received under the swap agreements are reflected as adjustments to interest income. These interest rate swap agreements are considered cash flow hedge derivative instruments that qualify for hedge accounting. The notional amounts of the interest rate swaps are not exchanged and do not represent exposure to credit loss. In the event of default by a counter party, the risk in these transactions is the cost of replacing the agreements at current market rates. During the second quarter, the Bank sold one of the rate swaps and received $868,000 as total proceeds from the sale. The Bank recognized a $778,000 gain on the sale of the rate swap that is included in other income on the three and six months ended consolidated statements of income.

The effects of derivative instruments on the Financial Statements for June 30, 2010 and December 31, 2009, are as follows:

Asset Derivatives at dates shown:

(Dollars in thousands)	**June 30, 2010**				
Derivatives designated as hedging instruments	**Notional/ Contract Amount**	**Estimated Net Fair Value**	**Estimated Net Fair Value**	**Expiration Date**	**Fixed Rate**
Interest rate swap - 5 year cash flow	$ 20,000	$ 773	other assets	11/26/2013	5.28%
Interest rate swap - 4 year cash flow	10,000	201	other assets	5/27/2013	4.54%
	$ 30,000	**$ 974**			**5.03%**

(Dollars in thousands)	**December 31, 2009**
Derivatives designated as hedging instruments	**Fixed Rate**

	Notional/ Contract Amount	Fair Value Balance Sheet Location	Estimated Net Fair Value	Expiration Date	
Interest rate swap - 4 year cash flow	$ 30,000	$ 225	other assets	11/26/2012	4.97%
Interest rate swap - 5 year cash flow	20,000	39	other assets	11/26/2013	5.28%
Interest rate swap - 4 year cash flow	10,000	(146)	other assets	5/27/2013	4.54%
	$ 60,000	**$ 118**			**5.00%**

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For three months ended June 30, 2010 and June 30, 2009

(Dollars in thousands)

Derivatives in cash flow hedging relationships	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Amount of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)	
	2010	2009		2010	2009
Interest rate swap - 4 year cash flow	$ (406)	(675)	Other income	$ (22)	(18)
Interest rate swap - 5 year cash flow	535	(693)	Other income	11	(10)
Interest rate swap - 4 year cash flow	228	(261)	Other income	0	0
	$ 357	**(1,629)**		**$ (11)**	**(28)**

For six months ended June 30, 2010 and June 30, 2009

(Dollars in thousands)

Derivatives in cash flow hedging relationships	Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Amount of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion)	
	2010	2009		2010	2009
Interest rate swap - 4 year cash flow	$ (152)	(660)	Other income	$ (5)	(1)
Interest rate swap - 5 year cash flow	781	(750)	Other income	22	0
Interest rate swap - 4 year cash flow	348	(261)	Other income	0	0
	$ 977	**(1,671)**		**$ 17**	**(1)**

Under the terms of the agreement, the Bank pays interest monthly at the rate equivalent to Wall Street Journal prime and receives interest income monthly at the fixed rate shown above.

Recent Accounting Pronouncements

In June 2009, the FASB issued new guidance relating to the accounting for transfers of financial assets. The new guidance, which was issued as SFAS No. 166, Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140 , was adopted into Codification in December 2009 through the issuance of Accounting Standards Updated (ASU) 2009-16. The new standard provides guidance to improve the relevance, representational faithfulness, and comparability of the information that an entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. The adoption of the new guidance did not have a material impact on the Corporation s consolidated financial statements.

In June 2009, the FASB issued new guidance relating to the variable interest entities. The new guidance, which was issued as SFAS No. 167, Amendments to FASB Interpretation No. 46(R), was adopted into Codification in December 2009. The objective of the guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. SFAS No. 167 is effective as of January 1, 2010. The adoption of the new guidance did not have a material impact on the Corporation s consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update No. 2009-15 (ASU 2009-15), Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing. ASU 2009-15 amends Subtopic 470-20 to expand accounting and reporting guidance for own-share lending arrangements issued in contemplation of convertible debt issuance. ASU 2009-15 is effective for fiscal years beginning on or after December 15, 2009 and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The adoption of the new guidance did not have a material impact on the Corporation s consolidated financial statements.

In January 2010, the FASB issued ASU 2010-04, *Accounting for Various Topics Technical Corrections to SEC Paragraphs*. ASU 2010-04 makes technical corrections to existing SEC guidance including the following topics: accounting for subsequent investments, termination of an interest rate swap, issuance of financial statements - subsequent events, use of residential method to value acquired assets other than goodwill, adjustments in assets and

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liabilities for holding gains and losses, and selections of discount rate used for measuring defined benefit obligation. The adoption of the new guidance did not have a material impact on the Corporation s consolidated financial statements.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of the new guidance did not have a material impact on the Corporation s consolidated financial statements.

In February 2010, the FASB issued Accounting Standards Update No. 2010-08, Technical Corrections to Various Topics. ASU 2010-08 clarifies guidance on embedded derivatives and hedging. ASU 2010-08 is effective for interim and annual periods beginning after December 15, 2009. The adoption of the new guidance did not have a material impact on the Corporation s consolidated financial statements.

In February 2010, the FASB issued Accounting Standards Update No. 2010-09, Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements. ASU 2010-09 addresses both the interaction of the requirements of Topic 855 with the SEC s reporting requirements and the intended breadth of the reissuance disclosures provisions related to subsequent events. An entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. ASU 2010-09 is effective immediately. The adoption of the new guidance did not have a material impact on the Company s consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. The new disclosure guidance will significantly expand the existing requirements and will lead to greater transparency into a Corporation s exposure to credit losses from lending arrangements. The extensive new disclosures of information as of the end of a reporting period will become effective for both interim and annual reporting periods ending at December 31, 2010. Specific items regarding activity that occurred before the issuance of the ASU, such as the allowance rollforward and modification disclosures, will be required for periods beginning after December 31, 2010. The Corporation is currently assessing the impact that ASU 2010-20 will have on its consolidated financial statements.

Note 2: Other Commitments

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities which are not reflected in the accompanying financial statements. These commitments include various guarantees and commitments to extend credit. 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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Corporation s subsidiary bank evaluates each customer s credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management s credit evaluation of the customer. Standby letters of credit and financial guarantees written are conditional commitments to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Bank holds collateral supporting those commitments when deemed necessary by management. As June 30, 2010, $31,735,000 of performance standby letters of credit have been issued. The Corporation does not anticipate any losses as a result of these transactions.

Note 3: Fair Value Measurements

Fair Value Measurements under generally accepted accounting principles defines fair value, describes a framework for measuring fair value and requires disclosures about fair value measurements by establishing a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the assets or liabilities fall within different levels of the hierarchy, the classification is based on the lowest level input that is significant to the fair value measurement of the asset or liability. Classification of assets and liabilities within the hierarchy considers the markets in which the assets and liabilities are traded and the reliability and transparency of the assumptions used to determine fair value.

The three levels are defined as follows: Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar instruments in markets that are not

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active or by model-based techniques in which all significant inputs are observable in the market for the asset or liability, for substantially the full term of the financial instrument. Level 3 the valuation methodology is derived from model-based techniques in which at least one significant input is unobservable to the fair value measurement and based on the Corporation s own assumptions about market participants assumptions.

Following is a description of the valuation methodologies used for instruments measured on a recurring basis at estimated fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

Securities

Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, securities are classified within Level 2 and fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. All of the Corporation s securities are classified as available for sale.

Interest Rate Swaps

Cash flow interest rate swaps are classified within Level 2 with fair values determined by quoted market prices and mathematical models using current and historical data.

The Corporation had no fair value liabilities at June 30, 2010 or December 31, 2009. A summary of assets at June 30, 2010 and December 31, 2009, measured at estimated fair value on a recurring basis were as follows:

June 30, 2010

(Dollars in Thousands)	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value Measurements**
Securities available for sale:				
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies	$ 0	$ 123,707	$ 0	$ 123,707
Debt securities issued by states and political subdivisions	0	58,710	0	58,710
Government residential mortgage-backed securities	0	143,279	0	143,279
Total debt securities	$ 0	$ 325,696	$ 0	$ 325,696
Equity securities	1,957	254	0	2,211
Total securities	$ 1,957	$ 325,950	$ 0	$ 327,907
Interest rate swaps	0	974	0	974
Total assets	$ 1,957	$ 326,924	$ 0	$ 328,881

December 31, 2009

(Dollars in Thousands)	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value Measurements**
Securities available for sale:				
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies	$ 0	$ 119,416	$ 0	$ 119,416
Debt securities issued by states and political subdivisions	0	37,384	0	37,384
Government residential mortgage-backed securities	0	37,872	0	37,872

Total debt securities	$ 0	$ 94,672	$ 0	$ 194,672
Equity securities	1,334	247	0	1,581
Total securities	$ 1,334	$ 194,919	$ 0	$ 196,253
Interest rate swaps	0	118	0	118
Total assets	$ 1,334	$ 195,037	$ 0	$ 196,371

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with accounting principles generally accepted in the United States. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Corporation to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

Loans Held for Sale

Loans held for sale are carried at the lower of cost or fair value. These loans typically consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Corporation records any fair value adjustments on a nonrecurring basis. At June 30, 2010 and December 31, 2009, loans held for sale were included in total loans on the balance sheet and were recorded at cost, which approximates their fair value.

Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due, according to the contractual terms of the loan agreement, will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loan, less estimated costs to sell. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The value of the real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Corporation using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is older than two years, then the fair value is considered Level 3. The value of business equipment is based upon an outside appraisal, if deemed significant, or the net book value on the applicable business financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans with an allocation to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the consolidated statement of income. Specific allocations to the allowance for loan losses were $4,783,000 and $4,801,000 at June 30, 2010 and December 31, 2009, respectively.

Other Real Estate Owned

Certain assets such as other real estate owned (OREO) are measured at the lower of cost or fair value less cost to sell. There were no OREO write-downs for the quarter ended June 30, 2010.

Goodwill and Intangible Assets

Goodwill is valued at the fair value of the assets and liabilities at the time of purchase. Intangible assets are valued based on the purchase price agreed to at the time of purchase.

A summary of assets at June 30, 2010 and December 31, 2009 measured at fair value on a nonrecurring basis is as follows:

June 30, 2010

(Dollars in Thousands)	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value Measurements**
Impaired loans, net	$ 0	$ 0	$ 10,620	$ 10,620
OREO	0	1,265	0	1,265
Loans held for sale	0	4,174	0	4,174

December 31, 2009

(Dollars in Thousands)	**Level 1**	**Level 2**	**Level 3**	**Total Fair Value Measurements**
Impaired loans, net	$ 0	$ 0	$ 10,702	$ 10,702
OREO	0	1,065	0	1,065
Loans held for sale	0	594	0	594

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Fair values of financial instruments

The corporation meets the requirements for disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Certain financial instruments and all non-financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Corporation.

The following methods and assumptions were used by the Corporation in estimating fair values of financial instruments as disclosed herein:

Cash, Due from Banks, Short-Term Investments, Interest Bearing Deposits with Banks and Federal Funds Sold

The carrying amounts of cash, due from banks, short-term investments, interest bearing deposits with banks and federal funds sold approximate their fair value.

Securities Available for Sale

Fair values for investment securities are based on quoted market prices.

Interest Rate Swaps

Fair values for cash flow interest rate swaps are determined by quoted market prices and mathematical models using current and historical data.

Loans Receivable

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for fixed rate 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 values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Restricted Bank Stock

These investments are carried at cost. The Corporation is required to maintain minimum investment balances in these stocks, which are not actively traded and therefore have no readily determinable market value.

Deposit Liabilities

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

Short-Term Borrowings

The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Corporation s current incremental borrowing rates for similar types of borrowing arrangements.

Long-Term Borrowings

The fair value of the Corporation s fixed rate long-term borrowings is estimated using a discounted cash flow analysis based on the Corporation s current incremental borrowing rate for similar types of borrowing arrangements. The carrying amounts of variable-rate long-term borrowings approximate their fair values at the reporting date.

Accrued Interest

The carrying amounts of accrued interest approximate their fair values.

Off-Balance-Sheet Instruments

The Corporation generally does not charge commitment fees. Fees for standby letters of credit and other off-balance-sheet instruments are not significant.

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The estimated fair values of the Corporation s financial statements were as follows at June 30, 2010 and December 31, 2009:

	June 30, 2010		December 31, 2009	
(Dollars in thousands)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial Assets				
Cash, due from banks, interest bearing deposits with banks and short-term investments	$ 24,085	$ 24,085	$ 20,929	$ 20,929
Federal funds sold	20,705	20,705	8,000	8,000
Securities available for sale	327,907	327,907	196,253	196,253
Restricted bank stocks	8,056	8,056	8,056	8,056
Interest rate swaps	974	974	118	118
Loans	898,128		881,074	
Allowance for loan losses	(14,582)		(11,067)	
Net loans	883,546	878,704	870,007	858,975
Accrued interest receivable	4,762	4,762	4,605	4,605
Total financial assets	$ 1,270,035	$ 1,265,193	$ 1,107,968	$ 1,096,936
Financial Liabilities				
Deposits	$ 1,089,550	$ 1,091,247	$ 915,170	$ 918,763
Short-term borrowed funds	45,367	45,367	97,914	97,914
Long-term borrowed funds	57,132	57,990	64,858	65,382
Accrued interest payable	899	899	1,040	1,040
Total financial liabilities	$ 1,192,948	$ 1,195,503	$ 1,078,982	$ 1,083,099

Note 4: Investments

At June 30, 2010 and December 31, 2009, the investment securities portfolio was comprised of securities classified as available for sale , resulting in investment securities being carried at fair value. The amortized cost and fair values of investment securities available for sale at June 30, 2010 and December 31, 2009 were:

(Dollars in thousands)	**Amortized Cost**	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
		June 30, 2010		
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies	$ 121,346	$ 2,401	$ 40	$ 123,707
Debt securities issued by states and political subdivisions	57,635	1,302	227	58,710
Government residential mortgage-backed securities	141,601	1,763	85	143,279
Equity securities	2,564	14	367	2,211
Totals	$ 323,146	$ 5,480	$ 719	$ 327,907
Short term investments	$ 6,247	$ 0	$ 0	$ 6,247
(Dollars in thousands)		**December 31, 2009**		
	$ 120,772	$ 160	$ 1,516	$ 119,416

Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies				
Debt securities issued by states and political subdivisions	36,867	760	243	37,384
Government residential mortgage-backed securities	37,489	637	253	37,873
Equity securities	1,894	2	316	1,580
Totals	$ 197,022	$ 1,559	$ 2,328	$ 196,253
Short term investments	$ 6,388	$ 0	$ 0	$ 6,388

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Investment Security Unrealized Losses:

The following table shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position, at June 30, 2010 and December 31, 2009:

	Less than 12 Months		12 Months or More		Total	
(Dollars in thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
			June 30, 2010			
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies	$ 11,334	$ 40	$ 0	$ 0	$ 11,334	$ 40
Debt securities issued by states and political subdivisions	2,275	56	473	171	2,748	227
Government residential mortgage-backed securities	14,554	85	0	0	14,554	85
Total debt securities	28,163	181	473	171	28,636	352
Equity securities	865	59	767	308	1,632	367
Total temporarily impaired securities	$ 29,028	$ 240	$ 1,240	$ 479	$ 30,268	$ 719
			December 31, 2009			
Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies	$ 96,673	$ 1,516	$ 0	$ 0	$ 96,673	$ 1,516
Debt securities issued by states and political subdivisions	9,889	98	483	145	10,372	243
Government residential mortgage-backed securities	10,913	253	0	0	10,913	253
Total debt securities	117,475	1,867	483	145	117,958	2,012
Equity securities	182	3	979	313	1,161	316
Total temporarily impaired securities	$ 117,657	$ 1,870	$ 1,462	$ 458	$ 119,119	$ 2,328

The previous table represents fifty-eight investment securities at June 30, 2010, and ninety-eight investment securities at December 31, 2009, where the current fair value is less than the related amortized cost. Management believes the impairments to be temporary in all cases for both periods disclosed. Consideration is given to the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value and the likelihood of being required to sell the investments.

At June 30, 2010, the Corporation held one state and political subdivision issue with a fair value less than the related amortized cost for twelve months or more. This is a California issue that is carrying a low market value due to the state s economic issues. It does not reflect any deterioration of the credit worthiness of the issuing entity. As management intends to hold and it is more likely than not that management will not be required to sell this security for the foreseeable future, the decline is not deemed to be other than temporary. Twenty-seven marketable equity securities have unrealized losses for twelve months or more. Eight of these twenty-seven equity securities are financial institution securities; our overall approach to the bank holdings was to consider those trading under their book value as temporarily impaired due to extreme market conditions within the financial sector. We also considered the ability to continue paying dividends as a factor in the long-term worth of these securities. Nineteen of the twenty-seven equity securities are non-financials or industrial securities; we continue to view these companies as valuable long-term holdings in the diversified portfolio. Factors considered were earnings, the ability to pay a dividend and the outlook for recovery in the industrial sector long-term. Since these companies are considered viable and carry the possibility of price appreciation in the future, impairments are considered temporary.

At December 31, 2009, the Corporation held one state and political subdivision issue with a fair value less than the related amortized cost for twelve months or more. This is a California issue that is carrying a low market value due to the state s economic issues. It does not reflect any deterioration of the credit worthiness of the issuing entity. As management intends to hold, and it is more likely, than not, that management will not be required to sell this security for the foreseeable future, the decline is not deemed to be other than temporary. Thirty-three marketable equity securities have unrealized losses for twelve months or more. Twelve of these thirty-three equity securities are financial institution securities; our overall approach to the bank holdings was to consider those trading under their book value as temporarily impaired due to extreme market conditions within the financial sector. We also considered the ability to continue paying dividends as a factor in the long-term worth of these securities. Twenty-one of the thirty-three equity securities are non-financials or

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industrial securities; we continue to view these companies as valuable long-term holdings in the diversified portfolio. Factors considered were earnings, the ability to pay a dividend and the outlook for recovery in the industrial sector long-term. Since these companies are considered viable and carry the possibility of price appreciation in the future, impairments are considered temporary. The Corporation recorded $36,000 of equity securities impairment expense during the first quarter of 2009.

The amortized cost and fair values of investment securities available for sale and short term investments at June 30, 2010, by contractual maturity are shown below. Contractual maturities will differ from expected maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Investment Portfolio

	Available for Sale		Short Term Investments	
(Dollars in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 8,819	$ 8,851	$ 3,519	$ 3,519
Due after one year through five years	44,162	44,649	2,728	2,728
Due after five years through ten years	85,047	87,076	0	0
Due after ten years	40,953	41,841	0	0
Government Backed Residential Mortgage Securities	141,601	143,279	0	0
Equity securities	2,564	2,211	0	0
	$ 323,146	$ 327,907	$ 6,247	$ 6,247

Proceeds from sales of securities available for sale for three ended June 30, 2010 and 2009, were $157,529,000, and $13,158,000, respectively. Proceeds from sales of securities available for sale for six months ended June 30, 2010, and 2009, were $209,897,000 and $15,326,000, respectively. Gross gains and losses on sales for the quarter ended June 30, 2010 were $1,805,000 and $24,000. Gross gains and losses on sales for the quarter ended June 30, 2009 were $296,000 and $3,000. Gross gains and losses on sales for six months ended June 30, 2010 were $2,500,000 and $321,000, respectively. Gross gains and losses on sales for six months ended June 30, 2009 were $461,000 and $3,000 respectively.

Securities with a market value of $170,016,000 and $143,984,000 at June 30, 2010, and December 31, 2009, respectively, were pledged to secure public funds and for other purposes as required or permitted by law.

Note 5:

Shareholders Equity

On February 9, 2010, Orrstown Financial Services, Inc., filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission that provided the Corporation the ability to raise capital from time to time up to an aggregate of $80 million, through the sale of the Corporation s stock, preferred stock, debt securities, warrants and other securities. During March 2010 the Corporation completed a public offering of 1,481,481 shares of common stock at a price of $27.00 per share for gross proceeds of approximately $40,000,000. Net proceeds of $37,550,000, after deducting underwriting commissions and expenses were received on March 29, 2010.

Note 6:

Subsequent Events

Generally accepted accounting principles, Subsequent Events establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The Subsequent Events principle sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that should be made about events or transactions that occur after the balance sheet date. In preparing these financial statements, the Corporation evaluated the events and transactions that occurred through the date these financial statements were issued. The Corporation has not identified any events that require recognition or disclosure in the financial statements.

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PART I - FINANCIAL INFORMATION

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

Orrstown Financial Services, Inc. (the Corporation) is a financial holding Corporation with a wholly-owned bank subsidiary, Orrstown Bank. The following is a discussion of our consolidated financial condition at June 30, 2010 and results of operations for the three and six months ended June 30, 2010 and June 30, 2009. Throughout this discussion, the yield on earning assets is stated on a fully taxable-equivalent basis and balances represent average daily balances unless otherwise stated. The discussion and analysis should be read in conjunction with our Condensed Consolidated Financial Statements (Unaudited) and Notes thereto presented in this report. Certain prior period amounts, presented in this discussion and analysis, have been reclassified to conform to current period classifications.

Certain statements appearing herein which are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements refer to a future period or periods, reflecting management s current views as to likely future developments, and use words like may, will, expect, estimate, anticipate or similar terms. Because forward-looking statements involve certain risks, uncertainties and other factors over which the Corporation has no direct control, actual results could differ materially from those contemplated in such statements. These factors include (but are not limited to) the following: general economic conditions, changes in interest rates, changes in the Corporation s cost of funds, changes in government monetary policy, changes in government regulation and taxation of financial institutions, including changes resulting from the Dodd-Frank Wall Street Reform and Consumer Protection Act and related regulations, changes in the rate of inflation, changes in technology, the intensification of competition within the Corporation s market area and other similar factors. For a discussion of these forward-looking statements and important factors that could cause results to differ materially from the forward-looking statements contained in this Report, see Important Factors Relating to Forward Looking Statements contained in our Annual Report on Form 10-K for the year ended December 31, 2009.

Critical Accounting Policies

The Bank policy related to the allowance for loan losses is considered to be a critical accounting policy because the allowance for loan losses represents a particularly sensitive accounting estimate. The amount of the allowance is based on management s evaluation of the collectability of the loan portfolio, including the nature of the loan portfolio, credit concentrations, trends in historical loss experience, specific impaired loans and economic conditions.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, grouping of like loans, grading of individual loan quality, review of specific problem loans, the examination of underlying collateral and current economic conditions that may affect the borrowers ability to pay.

SUMMARY OF FINANCIAL RESULTS

Orrstown Financial Services, Inc. recorded net income of $3,904,000 for the second quarter of 2010 compared to $3,454,000 for the same period in 2009, representing an increase of $450,000 or 13.0%. Basic earnings per share (EPS) decreased $0.05 to $0.49 in the recent quarter from the $0.54 earned during the second quarter of 2009. Diluted earnings per share for the second quarter were $0.47 versus $0.51 last year.

Included below are ratios for the return on average tangible assets (ROTA) and return on average tangible equity (ROTE) which exclude intangibles from the balance sheet and related amortization and tax expense from net income due to the associated goodwill and intangibles from the acquisition of companies and purchased deposits.

The following statistics compare the second quarter performance of 2010 to that of 2009:

	Three Months Ended	Six Months Ended

	June 2010	June 2009	June 2010	June 2009
Return on average assets	1.18%	1.26%	1.15%	1.20%
Return on average tangible assets	1.22%	1.30%	1.18%	1.24%
Return on average equity	10.20%	13.14%	11.04%	12.50%
Return on average tangible equity	12.02%	16.61%	13.23%	15.86%
Average equity / Average assets	11.56%	9.58%	10.42%	9.63%

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Supplemental Reporting of Non-GAAP-based Financial Measures

Return on average tangible assets and return on average tangible equity are non-GAAP-based financial measures calculated using non-GAAP-based amounts. The most directly comparable GAAP-based measures are return on average assets and return on average equity, which are calculated using GAAP-based amounts. The Corporation calculates the return on average tangible assets and equity by excluding the balance of intangible assets and their related amortization expense from the calculation of return on average assets and equity. Management uses the return on average tangible assets and equity to assess the Corporation s core operating results and believes that this is a better measure of our performance. In addition, this is consistent with the treatment by bank regulatory agencies, which exclude goodwill and other intangible assets from the calculation of risk-based capital ratios. However, these non-GAAP financial measures are supplemental and are not a substitute for an analysis based on GAAP measures. A reconciliation of return on average assets and equity to the return on average tangible assets and equity, respectively, is set forth below.

For Quarter Ended:	**June 30, 2010**	**June 30, 2009**
Return on Average Assets (GAAP basis)	1.18%	1.26%
Effect of excluding average intangible assets and related amortization	0.04%	0.04%
Return on Average Tangible Assets	1.22%	1.30%
Return on Average Equity (GAAP basis)	10.20%	13.14%
Effect of excluding average intangible assets and related amortization	1.82%	3.47%
Return on Average Tangible Equity	12.02%	16.61%
For Six Months Ended:	**June 30, 2010**	**June 30, 2009**
Return on Average Assets (GAAP basis)	1.15%	1.20%
Effect of excluding average intangible assets and related amortization	0.03%	0.04%
Return on Average Tangible Assets	1.18%	1.24%
Return on Average Equity (GAAP basis)	11.04%	12.50%
Effect of excluding average intangible assets and related amortization	2.19%	3.36%
Return on Average Tangible Equity	13.23%	15.86%

Tangible book value per share is a non-GAAP-based financial measure calculated using non-GAAP-based amounts. The most directly comparable GAAP-based measure is book value per share of common stock. In order to calculate tangible book value per share, the Corporation s management divides tangible common equity (a non-GAAP based financial measure calculated by subtracting intangible assets from common equity) by the number of shares of common stock outstanding. In contrast, book value per common share is calculated by dividing total shareholders equity by the number of shares of common stock outstanding. Management uses tangible book value per share because it believes such ratio is useful in understanding the Corporation s capital position and ratios. A reconciliation of book value per share to tangible book value per share is set forth below.

(Dollars in thousands)	**June 30, 2010**	**December 31, 2009**
Common shareholder s equity	$ 157,903	$ 110,886
Less: intangible assets	$ 20,808	$ 20,938
Tangible common equity	$ 137,095	$ 89,948
Book value per share	$ 19.81	$ 17.21
Less: intangible assets per share	$ 2.61	$ 3.25
Tangible book value per share	$ 17.20	$ 13.96

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RESULTS OF OPERATIONS

Quarter ended June 30, 2010 compared to Quarter ended June 30, 2009

Net interest income for the second quarter of 2010 was $11,300,000 representing a growth of $2,488,000, or 28.2% over the $8,812,000 realized during the second quarter last year. On a fully taxable equivalent basis (FTE), net interest income for the second quarter of 2010 and 2009 was $11,698,000 and $9,123,000, respectively. Net interest margin increased to 3.77% during the second quarter of 2010, an increase of 20 basis points from the second quarter of 2009, primarily as a result of a lower cost of funds. Earning asset yields have declined 47 basis points versus second quarter 2009 but cost of funds has declined 67 basis points versus the same period. We have kept liabilities relatively short and taken advantage of the normal yield curve.

The table that follows states rates on a fully taxable equivalent basis (FTE):

	Three Months Ended					
	June 2010			June 2009		
(Dollars in thousands)	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate
Interest Earning Assets:						
Federal funds sold & interest bearing bank balances	$ 32,301	$ 33	0.41%	$ 19,111	$ 13	0.27%
Investment securities	298,949	2,518	3.41%	155,757	1,494	3.84%
Total loans	901,812	12,383	5.45%	836,667	11,946	5.65%
Average interest-earning assets	1,233,062	14,934	4.82%	1,011,535	13,453	5.29%
Interest Bearing Liabilities:						
Interest bearing demand deposits	$ 402,872	$ 732	0.73%	$ 299,518	$ 829	1.11%
Savings deposits	63,679	45	0.28%	61,378	48	0.31%
Time deposits	483,824	1,970	1.63%	350,509	2,388	2.73%
Short term borrowings	67,571	81	0.48%	79,116	96	0.49%
Long term borrowings	50,620	408	3.19%	106,996	969	3.58%
Average interest bearing liabilities	1,068,566	3,236	1.22%	897,517	4,330	1.93%
Overall cost of funds			1.05%			1.72%
Net interest income / net interest spread		$ 11,698	3.60%		$ 9,123	3.36%
Net interest margin			3.77%			3.57%

Net Interest Income

FTE interest income totaled $14,934,000 for the second quarter of 2010 versus $13,453,000 for the same period last year, an increase of $1,481,000. This increase was achieved through a combination of rate and volume factors as our net interest margin has increased by 20 basis points versus second quarter 2009, and interest earning assets have increased by $222,000,000. The net interest margin increased primarily as a result of lower overall cost of funds. While our yields on interest earning assets have declined, we have seen a more rapid decrease in the cost of funds over this time frame. The overall cost of funds declined for the eighteenth consecutive month, to 1.05% for the second quarter of 2010 from 1.72% for the prior year quarter due to the lower interest rate environment, good available sources of funding and the decision to maintain a shorter duration in funding versus second quarter 2009.

Noninterest Income

Total noninterest income increased $3,338,000, or 76.7%, from $4,350,000 to $7,688,000. Net security gains realized in the second quarter of 2010 were $1,781,000 compared to the $293,000 taken in the second quarter of 2009. Revenue produced by our secondary mortgage market program grew $128,000 as refinancing activity has been brisk. Trust income increased by $197,000 as did brokerage fees by $90,000.

Noninterest Expense

Other expenses rose from $8,344,000 during the second quarter of 2009 to $8,724,000 during the same period of 2010, an increase of $380,000, or 4.6%. Salary expense increased by $283,000, or 9.5%, over the prior quarter. Benefit expense grew overall by $165,000. Profit sharing expense rose $49,000, or 13.1%, and employment tax expense increased by $14,000. These increases were attributable to the growth of the number of staff and annual merit increases.

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Equipment expense rose $12,000, or 1.8%, along with an increase in data processing of $26,000, or 9.3%, due to a $9,000 increase in merchant processing expense and a $7,000 increase in remote deposit capture expense. The cost of printing and supplies decreased $25,000 along with a $13,000 decrease in advertising expense.

Mortgage servicing expense decreased by $35,000 along with a decrease in FDIC insurance expense of $344,000, due to a special assessment of $515,000 that was taken in the second quarter of 2009.

The overhead efficiency ratio for Orrstown Financial Services, Inc. is 49.03% for the second quarter of 2010 versus 62.64% for the second quarter of 2009.

Six months ended June 30, 2010 compared to Six months ended June 30, 2009

Net Interest Income

Net interest income for the first six months of 2010 was $21,797,000, representing a growth of $4,963,000 over the $16,834,000 realized during the same period last year. On a fully taxable equivalent basis (FTE), net interest income for the first six months of 2010 and 2009 was $22,580,000 and $17,449,000, respectively.

The table that follows states rates on a fully taxable equivalent basis (FTE):

	Six Months Ended					
	June 2010			June 2009		
(Dollars in thousands)	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate	Average Balance	Tax Equivalent Interest	Tax Equivalent Rate
Interest Earning Assets:						
Federal funds sold & interest bearing bank balances	$ 28,031	$ 63	0.45%	$ 26,498	$ 33	0.25%
Investment securities	264,117	4,630	3.51%	139,483	2,788	4.01%
Total loans	895,971	24,409	5.43%	828,833	23,513	5.66%
Average interest-earning assets	1,188,119	29,102	4.89%	994,814	26,334	5.28%
Interest Bearing Liabilities:						
Interest bearing demand deposits	$ 376,749	$ 1,411	0.76%	$ 291,289	$ 1,662	1.15%
Savings deposits	62,078	90	0.29%	60,947	112	0.37%
Time deposits	462,590	3,926	1.68%	350,567	4,882	2.81%
Short term borrowings	94,554	245	0.52%	70,342	181	0.51%
Long term borrowings	51,950	850	3.28%	112,399	2,048	3.62%
Average interest bearing liabilities	1,047,921	6,522	1.25%	885,544	8,885	2.02%
Overall cost of funds			1.12%			1.80%
Net interest income/net interest spread		$ 22,580	3.64%		$ 17,449	3.26%
Net interest margin			3.77%			3.48%

Noninterest Income

Total noninterest income increased $3,842,000, or 46.2%, from $8,319,000 to $12,161,000. Net security gains during the first six months of 2010 were $2,179,000 compared to the $458,000 of net gains taken in the second quarter of 2009.

Service charges on deposits increased $316,000, or 9.7%, driven primarily by increases in service charges from the Mastermoney debit card program of $211,000 versus the prior year. Other income had a net increase of $1,205,000. The major contributor to this increase was a $778,000 gain taken on the sale of a fixed for prime floating rate swap. The swap was sold to provide the corporation more upside potential should rates rise. This moved the rate sensitive asset/rate sensitive liability position closer to even.

Trust and brokerage income has increased approximately $447,000, or 23.3%, due to higher brokerage income. Trust assets under management have increased to $521 million from $374 million at June 30, 2009, due to an increase in the overall value of stocks in general, as well as an increase in the number of accounts under management.

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Noninterest Expense

Other expenses rose from $16,021,000 during the first six months of 2009 to $17,510,000 during the same period of 2010, an increase of $1,489,000, or 9.3%. Salary expense increased by $605,000, or 10.4%, versus the prior year due to staff additions and annual increases. Benefit expense increased by $405,000 over the prior year, which included salary continuation expense increase of $171,000 due to added policies and profit sharing expense increase of $95,000 due to staff expansion. Most operating expenses grew commensurate with the overall growth of the Corporation.

The overhead efficiency ratio for Orrstown Financial Services, Inc, is 53.25% for the first six months of 2010. This compares to 2010 peer averages of approximately 65.1% for publicly traded banks of peer size ($1-5 billion), 68.8% for Mid Atlantic banks and 72.2% for all banks, per SNL Financial of Charlottesville, VA. SNL is a provider of information to the banking industry.

INCOME TAX EXPENSE

Income tax expense increased $580,000, or 27.1%, for the first six months of 2010 versus the same period for 2009. The marginal federal income tax bracket is 35% for 2010 and 2009. The 2010 effective tax rate has increased because low income housing tax credits are lower in 2010. In addition, 2009 benefited from a one time historic tax credit project.

Effective income tax rates were as follows:

	Three Months Ended		Six Months Ended	
	June 2010	June 2009	June 2010	June 2009
Effective income tax rate	25.8%	23.6%	27.1%	24.8%

PROVISION AND ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration factors such as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrowers ability to pay. Through this review and evaluation process, an amount deemed adequate to meet current growth and future loss expectations is charged to operations. The unallocated portion of the reserve ensures that any additional unforeseen losses that are not otherwise identifiable will be able to be absorbed. It is intended to provide for imprecise estimates in assessing projected losses, uncertainties in economic conditions and allocating pool reserves. Management deems the total of the allocated and unallocated portions of the allowance for loan losses to be adequate to absorb any losses at this time.

The provision for loan losses amounted to $6,420,000 and $515,000 for the first six months of 2010 and 2009, respectively. The reserve to loan ratio for the Corporation was 1.62% at June 30, 2010, compared to 1.26% at December 31, 2009 and 0.88% on June 30, 2009. These provisions compared to net charge-offs of $2,438,000 during the second quarter 2010 and $61,000 during the same period last year. An unallocated amount of $2,279,000, or 15.6%, was included in the June 30, 2010 allowance versus $701,000 unallocated at March 31, 2010 and $1,262,000 unallocated at December 31, 2009.

The provision for loan losses and the other changes in the allowance for loan losses are shown below:

	Three Months Ended		Six Months Ended	
(Dollars in Thousands)	**June 2010**	**June 2009**	**June 2010**	**June 2009**
Balance at beginning of period	$ 12,020	$ 7,174	$ 11,067	$ 7,140
Provision for loan losses	5,000	300	6,420	515
Recoveries	67	8	85	12

Loan charge-offs	(2,505)	(69)	(2,990)	(254)
Balance at end of period	$ 14,582	$ 7,413	$ 14,582	$ 7,413

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NONPERFORMING ASSETS / RISK ELEMENTS

Nonperforming assets at June 30, 2010, March 31, 2010 and December 31, 2009 are as follows:

(Dollars in Thousands)	June 30, 2010	March 31, 2010	December 31, 2009
Loans on nonaccrual (cash) basis	$ 14,496	$ 23,020	$ 4,267
Loans whose terms have been renegotiated	0	0	0
Total nonperforming loans	14,496	23,020	4,267
OREO	1,264	873	1,065
Total nonperforming assets	15,760	23,893	5,332
Loans past due 90 or more days and still accruing	7,255	8,929	6,155
Total nonperforming and other risk assets	$ 23,015	$ 32,822	$ 11,487
Ratio of total nonperforming loans to loans	1.61%	2.56%	0.48%
Ratio of total nonperforming assets to assets	1.16%	1.82%	0.45%
Ratio of total risk assets to total loans and OREO	2.56%	3.65%	1.30%
Ratio of total risk assets to total assets	1.69%	2.49%	0.96%

Nonperforming loans totaled $14,496,000, or 1.61% of total loans, at June 30, 2010 compared to $23,020,000, or 2.56% of total loans, at March 31, 2010. Nonperforming loans declined since March 31, 2010 due to resolution of two of the three major nonperforming credits that were disclosed in the Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010. The remaining nonperforming credit of $8.6 million had its specific allocations increased from $1.48 million at March 31, 2010 to $2.98 million at June 30, 2010.

Other real estate owned increased by $199,000 to $1,264,000, from $1,065,000 at December 31, 2009, as a result of one addition to OREO taken during the second quarter of 2010. One property was sold during the second quarter of 2010 with two properties sold in the first quarter.

At June 30, 2010, the total recorded investment in impaired loans was $21,728,000, of which $15,403,000 had specific allowances determined in accordance with generally accepted accounting principles and $6,325,000 did not have specific allowances. The allowance for loan losses on these impaired loans amounted to $4,783,000 at June 30, 2010.

At December 31, 2009, the total recorded investment in impaired loans was $31,700,000, of which $15,503,000 had allowances determined in accordance with generally accepted accounting principles and $16,197,000 did not have allowances determined in accordance with generally accepted accounting principles. The allowance for loan losses on these impaired loans amounted to $4,801,000 at December 31, 2009.

Loans 30 to 89 days past due declined 45.8% from $19.0 million at December 31, 2009, to $10.3 million at June 30, 2010.

CAPITAL

Orrstown Financial Services, Inc. is a financial holding company and, as such, must maintain a well capitalized status in its bank subsidiary. Management foresees no problem in maintaining capital ratios well in excess of regulatory minimums.

A comparison of Orrstown Financial Services, Inc. s capital ratios to regulatory minimum requirements at June 30, 2010 are as follows:

	Orrstown Financial Services, Inc.	Regulatory Minimum	Regulatory Well Capitalized Minimum

Leverage Ratio	10.0%	4%	5%
Risk Based Capital Ratios:			
Tier I Capital Ratio	14.0%	4%	6%
Total (Tier I & II) Capital Ratio (core capital plus allowance for loan losses)	15.3%	8%	10%

The Corporation completed a public offering of 1,481,481 shares of common stock at a price of $27.00 per share, for gross proceeds of approximately $40,000,000 during the first quarter 2010. Net proceeds after deducting underwriting commissions and expenses are $37,550,000. Additional growth during the second quarter of 2010 is a result of capital growth in the form of retained earnings. All growth experienced during 2009 has been supported by capital growth in the form of retained earnings. Equity represented 11.6% of assets at June 30, 2010 and 9.3% at December 31, 2009.

A Bank Holding Company inspection, Commercial Bank and Information Technology examination was completed during the second quarter of 2010. Management is not aware of any current recommendations by regulatory authorities which, if implemented, would have a material effect on the Corporation s liquidity, capital resources or operations.

LIQUIDITY

The primary function of asset/liability management is to assure adequate liquidity while minimizing interest rate risk. Liquidity management involves the ability to meet the cash flow requirements of customers who may be either depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. Sources of liquidity include investment securities, loan and lease income and payments and increases in customer s deposit accounts. Additionally, Orrstown Bank is a Federal Home Loan Bank (FHLB) member and standard credit arrangements available to FHLB members provide increased liquidity. Recognizing the need for varied funding sources, we have established modest relationships using other nontraditional sources, as provided for in our contingency funding plan. We have tested those facilities and are comfortable with our relationships. Liquidity was primarily provided by operating activities and the sale and maturities of available for sale securities.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is defined as the exposure to interest rate risk, foreign currency exchange rate risk, commodity price risk, and other relevant market rate or price risks. For domestic banks, the majority of market risk is related to interest rate risk.

Interest rate sensitivity management requires the maintenance of an appropriate balance between interest sensitive assets and liabilities. Interest bearing assets and liabilities that are maturing or repricing should be adequately balanced to avoid fluctuating net interest margins and to enhance consistent growth of net interest income through periods of changing interest rates. The Corporation has consistently followed a strategy of pricing assets and liabilities according to prevailing market rates while largely matching maturities, within the guidelines of sound marketing and competitive practices. Rate sensitivity is measured by monthly gap analysis, quarterly rate shocks, and periodic simulation. The cumulative gap position at 12 months is slightly negative at $150 million at June 30, 2010 and the RSA/RSL cumulative ratio is 0.74%, versus 0.88% reported at December 31, 2009. The Corporation enjoys a closely balanced position that does not place it at undue risk under any interest rate scenario. Many of the deposit dollars in transaction accounts are discretionarily priced so management maintains significant pricing flexibility.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures:

The Corporation s Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Corporation s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of June 30, 2010. Based on such evaluation, such officers have concluded that, as of June 30, 2010, the Corporation s disclosure controls and procedures are effective in alerting them on a timely basis to material information relating to the Corporation (including its consolidated subsidiary) required to be included in the Corporation s periodic filings under the Exchange Act.

(b) Changes in internal controls:

The Corporation regularly assesses the adequacy of its internal control over financial reporting and enhances its controls in response to internal control assessments and internal and external audit and regulatory recommendations. There have not been any significant changes in the Corporation s internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, such controls during the quarter ended June 30, 2010.

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PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

The nature of Orrstown Financial Services, Inc. s business generates a certain amount of litigation involving matters arising out of the ordinary course of business. In the opinion of management, there are no legal proceedings that might have a material effect on the results of operations, liquidity, or the financial position of the Corporation at this time.

Item 1A - Risk Factors

Except as disclosed herein, there have been no material changes from the risk factors as disclosed in the Annual Report on Form 10-K for the year ended December 31, 2009.

The Dodd-Frank Wall Street Reform and consumer Protection Act may affect our financial condition, results of operations, liquidity and stock price.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, was signed into law. The Dodd-Frank Act includes provisions affecting large and small financial institutions, including several provisions that will profoundly affect how community banks and bank holding companies will be regulated in the future. Among other things, these provisions relax rules regarding interstate branching, allow financial institutions to pay interest on business checking accounts, change the scope of federal deposit insurance coverage and impose new capital requirements on bank holding companies. In addition, there is significant uncertainty about the full impact of the Dodd-Frank Act because many of its provisions require subsequent regulatory rule making.

The Dodd-Frank Act establishes the Bureau of Consumer Financial Protection as an independent entity within the Federal Reserve, which will be given authority to promulgate Consumer protection regulations applicable to all entities offering financial services or products, including banks. Additionally, the Dodd-Frank Act includes a series of provisions covering mortgage loan origination standards affecting, among other things, originator compensation, minimum repayment standards and pre-payments.

The Dodd-Frank Act contains numerous other provisions affecting financial institutions of all types, many of which may have an impact on Orrstown s operating environment in substantial and unpredictable ways. Consequently, the Dodd-Frank Act is likely to affect our cost of doing business, it may limit or expand the activities in which Orrstown permissibly may engage and it may affect the competitive balance within Orrstown s industry and market areas.

The Dodd-Frank Act and the regulations to be adopted thereunder are expected to subject Orrstown and other financial institutions to additional restrictions, oversight and costs that may have an adverse impact on its business, financial condition, results of operations or the price of Orrstown common stock and Orrstown s ability to continue to conduct business consistent with historical practices.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

The table below summarizes the Corporation s repurchase of common equity securities during the quarter ended June 30, 2010:

	Total Number of Shares Purchased	**Average Price Paid per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)**	**Maximum Number of Shares that may Yet be Purchased Under the Plans or Programs (1)**
4/1/10 through 4/30/10		$	0	52,110
5/1/10 through 5/31/10			0	52,110
6/1/10 through 6/30/10			0	52,110
Total			0	

(1) On April 27, 2006, Orrstown Financial Services, Inc. announced a Stock Repurchase Plan approving the purchase of up to 150,000 shares as conditions allow. The plan may be suspended at any time without prior notice and has no prescribed time limit in which to fill the authorized repurchase amount. As of June 30, 2010, 97,890 shares have been purchased under the program.

The Corporation did not sell any unregistered securities during the quarter ended June 30, 2010.

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Item 3 - Defaults upon Senior Securities

Not applicable

Item 4 - (Removed and Reserved)

Item 5 - Other Information

None

Item 6 - Exhibits

3.1	Articles of Incorporation, as amended, incorporated by reference to Exhibit 3.1 of the Registrant s Report on Form 8-K filed on January 29, 2010.
3.2	By-laws, as amended, incorporated by reference to Exhibit 3.2 of the Registrant s Report on Form 8-K filed on January 29, 2010.
4	Instruments defining the rights of security holders including indentures. The rights of the holders of Registrant s common stock are contained in: (i) Articles of Incorporation, as amended, incorporated by reference to Exhibit 3.1. (ii) By-laws, as amended, incorporated by reference to Exhibit 3.2.
31.1	Rule 13a - 14(a)/15d-14(a) Certification (Chief Executive Officer) filed herewith
31.2	Rule 13a - 14(a)/15d-14(a) Certifications (Chief Financial Officer) filed herewith
32.1	Section 1350 Certifications (Chief Executive Officer) filed herewith
32.2	Section 1350 Certifications (Chief Financial Officer) filed herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

/s/ Thomas R. Quinn, Jr.
(Thomas R. Quinn, Jr., President & CEO)
(Duly Authorized Officer)

/s/ Bradley S. Everly
(Bradley S. Everly, Senior Vice President & CFO)
(Principal Financial Officer)

Date: August 5, 2010

ORRSTOWN FINANCIAL SERVICES, INC. AND SUBSIDIARIES

EXHIBIT INDEX

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