2012 Annual Report

Commercial National Financial Corporation

Stock Information

Commercial National Financial Corporation's common stock is quoted and traded under the symbol "CNAF" on the OTCQB Marketplace, operated by OTC Markets Group. Stock information may be accessed on the OTC Markets website via the following address: www.otcmarkets.com. At this website, investors have the ability to see all of the broker-dealer quotes and the size of those quotes.

Market Makers

The following firms have committed to make a market in the stock of Commercial National Financial Corporation. Inquiries concerning their services should be directed to:

Boenning & Scattergood, Inc.
200 Barr Harbor Dr.
4 Tower Bridge, Suite 300
West Conshohocken, PA 19428
boenningandscattergood.com
800-883-1212

Buckman, Buckman & Reid
174 Patterson Ave.
Shrewsbury, NJ 07702
buckmanbuckman.com
800-531-0303

Canaccord Genuity Securities
350 Madison Ave., 10th Fl.
New York, NY 10005
canaccordgenuity.com
212-389-8000

Cantor Fitzgerald & Co.
39 Avenue of the Commons
Suite 205
Shrewsbury, NJ 07702
cantor.com
732-380-3800

Citadel Securities
131 South Dearborn St.
Chicago, IL 60603
citadelgroup.com
312-395-2100

G1 Execution Services, LLC
One Financial Place
440 S. La Salle St., Suite 3030
Chicago, IL 60605
g1x.com
800-387-2331

Guggenheim Securities, LLC
330 Madison Ave, 8th Fl.
New York, NY 10017
guggenheimpartners.com
212-739-0700

Knight Execution & Clearing
545 Washington Blvd.
Jersey City, NJ 07310
knight.com
877-794-9511

Maxim Group LLC
405 Lexington Ave., 2nd Fl.
New York, NY 10174
maximgrp.com
800-724-0761

Mcadams Wright Ragen, Inc.
925 4th Ave., Suite 3900
Seattle, WA 98104
mwrinc.com
888-567-6297

Monroe Securities, Inc.
100 N. Riverside Plaza, Suite 1620
Chicago, IL 60606
monroesecurities.com
312-327-2530

Stifel, Nicolaus & Company
100 Light St.
Baltimore, MD 21202
stifel.com
800-223-7922

Stockcross Financial
15 Exchange Place
Jersey City, NJ 07302
stockcross.com
800-225-6196

UBS Securities LLC
677 Washington Blvd., 6th Fl.
Stamford, CT 06901
ubs.com
203-719-3000

Transfer Agent

Registrar and Transfer Company
Attn: Investor Relations
10 Commerce Drive
Cranford, NJ 07016-3572
Email: info@rtco.com
rtco.com
800-368-5948

Commercial National Financial Corporation

Board of Directors

John T. Babilya
President, Arc Weld, Inc.

George A. Conti, Jr.
Attorney at Law

Gregg E. Hunter
Vice-Chairman,
Commercial National Financial Corporation
Chairman, President and CEO,
Commercial Bank & Trust of PA

R. Dale Landers
Senior Consultant,
Water Treatment Services, Inc.

Steven H. Landers
Vice President, Service,
R&L Development Co.

Joseph A. Mosso
Retired, former President,
Mosso's Pharmacy, Inc.

Bruce A. Robinson
General Manager,
Laurel Valley Golf Club

Wendy S. Schmucker
Senior Vice President,
Secretary/Treasurer,
Commercial Bank & Trust of PA

Debra L. Spatola
Owner,
Debra Jeanne Designs

George V. Welty
Attorney at Law
Chairman, Commercial National
Financial Corporation

Commercial National Financial Corporation

A Letter to Our Shareholders

Year-end 2012 post-tax net income rose to $7,265,000. This earnings result for 2012 signifies yet another record earnings achievement for the Company. Recent sequential earnings results for the Company were $6,715,000 in 2011, $5,501,000 in 2010, $5,129,000 in 2009, $4,024,000 in 2008 and $3,065,000 in 2007.

During the second half of 2011 an expansion of high-yield municipal bond leverage materially influenced earnings for that time period. During the first quarter of 2012 that leverage position was extensively reduced inducing an earnings and equity capture of considerable magnitude which profoundly shaped individual quarterly and full year results for 2012. In the aftermath of this deleveraging, the Company's core earnings continue to be driven by outstanding earning asset credit quality, strong net interest margin, effective overhead cost containment and exceptional tax efficiency.

The Company's capital adequacy continues to vastly surpass both present and proposed regulatory standards even after December 2012's special $1.00 per share cash dividend payments to all the Company's common stock shareholders. At year-end 2012 the Company had Tier One Capital of $47.1 million and Total Equity Capital of $48.7 million. Tier One Risk-Based, Total Risk-Based and Leverage Capital ratios for year-end 2012 were 23.13%, 23.94% and 13.09% respectively.

The special $1.00 per share cash dividend was only made possible by the broad discretionary latitude afforded by the Company's exemplary financial condition and financial performance which have been successfully maintained over a multi-year period of unprecedented banking industry turmoil.

The decision by the Company's board of directors to declare the special $1.00 per share cash dividend was driven by the exceedingly high earnings generated during both 2011 and 2012 which were heavily influenced by unique financial market circumstances.

Providing an attractive and reliable cash dividend income stream to our shareholders continues to be a top priority for the Company.

High cash dividends and high dividend yields help buttress Commercial National Financial Corporation's common stock market share price valuations which continue to significantly exceed prevailing banking industry norms.

The Company begins a challenging 2013 from a position of considerable financial strength and that strength will be preserved through strict adherence to disciplined underwriting and investment practices. This strength will be augmented by balanced operational controls so that potential opportunities may be fully seized upon and exploited to reinforce 2013's financial performance in a risk-balanced manner.

Going forward Commercial National Financial Corporation will continue to carefully deploy its resources through a long-term strategy designed to produce meaningful results that merit the ongoing support of you, the owners of this Company.

George V. Welty
Chairman

Gregg E. Hunter
Vice Chairman, President and Chief Executive Officer

Corporate Headquarters
900 Ligonier Street, Latrobe
724-539-3501 | 724-539-1137 (fax)

Courthouse Square Office
19 North Main Street, Greensburg
724-836-7699 | 724-836-7697 (fax)
Monday-Friday 8:30 A.M.-4:30 P.M.

Eastgate Office
867 Georges Station Road, Greensburg
724-836-7600 | 724-836-7604 (fax)
Monday-Thursday 9 A.M.-5 P.M.
Friday 9 A.M.-6 P.M., Saturday 9 A.M.-1 P.M.

Latrobe Office
900 Ligonier Street, Latrobe
724-539-3501 | 724-537-9966 (fax)
Monday-Thursday 9 A.M.-4 P.M.
Friday 9 A.M.-5 P.M.

Lawson Heights Office
11 Terry Way, Latrobe
724-539-9774 | 724-539-3523 (fax)
Monday-Thursday 9 A.M.-5 P.M.
Friday 9 A.M.-6 P.M., Saturday 9 A.M.-1 P.M.

Ligonier Office
201 West Main Street, Ligonier
724-238-9538 | 724-238-9530 (fax)
Monday-Thursday 8:30 A.M.-4:30 P.M.
Friday 8:30 A.M.-6 P.M., Saturday 9 A.M.-12 Noon

Lincoln Road Office
Lincoln Road Shopping Center
1920 Lincoln Avenue, Latrobe
724-537-9980 | 724-537-9982 (fax)
Monday-Thursday 9 A.M.-4 P.M.
Friday 9 A.M.-5 P.M., Saturday 9 A.M.-1 P.M.

Lincoln Road Drive-Up
2004 Lincoln Avenue, Latrobe
Monday-Thursday 9 A.M.-5 P.M.
Friday 9 A.M.-6 P.M., Saturday 9 A.M.-1 P.M.

Norwin Hills Office
Norwin Hills Shopping Center
8775 Norwin Avenue, North Huntingdon
724-864-7536 | 724-864-7531 (fax)
Monday-Thursday 9 A.M.-4 P.M.
Friday 9 A.M.-6 P.M., Saturday 9 A.M.-1 P.M.

Pleasant Unity Office
2059 Route 130, Pleasant Unity
724-423-5222 | 724-423-1155 (fax)
Monday-Thursday 9 A.M.-4 P.M.
Friday 9 A.M.-5 P.M., Saturday 9 A.M.-12 Noon

West Newton Office
109 East Main Street, West Newton
724-872-5100 | 724-872-5143 (fax)
Monday-Thursday 9 A.M.-4 P.M.
Friday 9 A.M.-6 P.M., Saturday 9 A.M.-12 Noon

West Point Office
West Point Plaza
106 West Point Drive, Greensburg
724-552-0137 | 724-552-0145 (fax)
Monday-Wednesday, Friday 8:30 A.M.-4:00 P.M.
Thursday 8:30 A.M.-6 P.M., Saturday 9 A.M.-12 Noon

Asset Management and Trust Division
19 North Main Street, Greensburg
724-836-7670 | 724-836-7675 (fax)
Monday-Friday 8 A.M.-4:30 P.M.

ParenteBeard

Independent Auditors' Report

Board of Directors and Shareholders
Commercial National Financial Corporation

We have audited the accompanying consolidated financial statements of Commercial National Financial Corporation and its subsidiaries, which comprise the consolidated statements of financial condition as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Commercial National Financial Corporation and its subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

ParenteBeard LLC

Pittsburgh, Pennsylvania
March 25, 2013

Consolidated Statements of Financial Condition

	December 31, 2012	December 31, 2011
	(Dollars in Thousands, Except per Share Amounts)	
Assets		
Cash and due from banks	**$ 6,468**	$ 6,275
Interest bearing deposits with banks	**32,113**	185
Cash and Cash Equivalents	**38,581**	6,460
Investment securities available for sale	**141,321**	189,898
Restricted investments in bank stock	**2,506**	3,534
Loans receivable	**168,886**	179,386
Allowance for loan losses	**(1,649)**	(1,673)
Net Loans	**167,237**	177,713
Premises and equipment, net	**3,136**	3,085
Accrued interest receivable	**1,481**	2,545
Investment in life insurance	**16,562**	16,021
Other assets	**2,238**	1,790
Total Assets	**$373,062**	$401,046
Liabilities and Shareholders' Equity		
Liabilities		
Deposits (all domestic):		
Non-interest bearing	**$103,437**	$ 89,690
Interest bearing	**213,020**	214,126
Total Deposits	**316,457**	303,816
Short-term borrowings	**0**	29,450
Long-term borrowings	**0**	10,000
Other liabilities	**3,839**	5,231
Total Liabilities	**320,296**	348,497
Shareholders' Equity		
Common stock, par value $2 per share; authorized 10,000,000 shares; issued 3,600,000 shares; outstanding 2,860,953 shares in 2012 and 2011	**7,200**	7,200
Retained earnings	**52,604**	51,175
Accumulated other comprehensive income	**5,506**	6,718
Treasury stock, at cost, 739,047 shares in 2012 and 2011	**(12,544)**	(12,544)
Total Shareholders' Equity	**52,766**	52,549
Total Liabilities and Shareholders' Equity	**$373,062**	$401,046

See notes to consolidated financial statements.

Consolidated Statements of Income

	Years Ended December 31,	
	2012	2011
	(In Thousands, Except per Share Amounts)	
Interest Income		
Interest and fees on loans	**$ 9,076**	$10,599
Interest and dividends on investments:		
Taxable	**2,745**	4,152
Exempt from federal income taxes	**3,547**	3,673
Other	**100**	1
Total Interest Income	**15,468**	18,425
Interest Expense		
Deposits	**1,170**	1,734
Short-term borrowings	**16**	59
Long-term borrowings	**1**	237
Total Interest Expense	**1,187**	2,030
Net Interest Income	**14,281**	16,395
Provision for Loan Losses	**0**	0
Net Interest Income after Provision for Loan Losses	**14,281**	16,395
Other Operating Income		
Trust department income	**939**	1,069
Service charges on deposit accounts	**1,102**	1,055
Net security gains	**3,317**	9
Income from investment in life insurance	**500**	508
Other income	**237**	227
Total Other Operating Income	**6,095**	2,868
Other Operating Expenses		
Salaries and employee benefits	**6,371**	6,132
Net occupancy	**829**	828
Furniture and equipment expense	**427**	400
Pennsylvania shares tax	**510**	503
Legal and professional fees	**352**	381
FDIC insurance	**192**	225
ATM expenses	**431**	391
Director fees	**433**	470
Software expense	**312**	280
Other expenses	**1,603**	1,679
Total Other Operating Expenses	**11,460**	11,289
Income before Income Taxes	**8,916**	7,974
Income Tax Expense	**1,651**	1,259
Net Income	**$ 7,265**	$ 6,715
Earnings per Share, Basic	**$ 2.54**	$ 2.35

See notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2012 and 2011

	Years Ended December 31,	
	2012	**2011**
	(In Thousands)	
Net Income	$7,265	$6,715
Other comprehensive income (loss), net of tax:		
Unrealized net gains on securities		
Unrealized holding gains arising during period	977	2,576
Less: Reclassification adjustment for gains included in net income	(2,189)	(7)
Other comprehensive (loss) income	(1,212)	2,569
Total Comprehensive Income	$6,053	$9,284

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Years Ended December 31, 2012 and 2011

(Dollars in thousands, except per share data)

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2010	$7,200	$47,207	$(12,544)	$4,149	$46,012
Net income	0	6,715	0	0	6,715
Other comprehensive income	0	0	0	2,569	2,569
Cash dividends paid $0.96 per share	0	(2,747)	0	0	(2,747)
Balance at December 31, 2011	**$7,200**	**$51,175**	**$(12,544)**	**$6,718**	**$52,549**
Net income	**0**	**7,265**	**0**	**0**	**7,265**
Other comprehensive loss	**0**	**0**	**0**	**(1,212)**	**(1,212)**
Cash dividends paid $2.04 per share	**0**	**(5,836)**	**0**	**0**	**(5,836)**
Balance at December 31, 2012	**$7,200**	**$52,604**	**$(12,544)**	**$5,506**	**$52,766**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2012	2011
	(In Thousands)	
Cash Flows from Operating Activities		
Net income	**$ 7,265**	$ 6,715
Adjustments to reconcile net income to net cash provided by Operating activities:		
Depreciation and amortization	**335**	332
Net security gains	**(3,317)**	(9)
Amortization of intangibles	**49**	98
Net accretion of securities and loan fees	**(27)**	(21)
Income from investment in life insurance	**(500)**	(508)
Loss on other real estate owned	**6**	46
Deferred tax expense (benefit)	**26**	(96)
Net decrease (increase) in accrued interest receivable and other assets	**395**	(903)
Net (decrease) increase in accrued interest payable and other liabilities	**(793)**	463
Net Cash Provided by Operating Activities	**3,439**	6,117
Cash Flows from Investing Activities		
Purchases of securities	**(34,594)**	(74,124)
Sale of securities	**65,116**	0
Maturities, calls and principal repayments of securities	**19,557**	19,314
Redemption of restricted investments in bank stock	**1,028**	805
Net decrease in loans	**10,354**	12,474
Proceeds from sale of foreclosed real estate	**252**	49
Purchases of premises and equipment	**(386)**	(94)
Net Cash Provided by (Used in) Investing Activities	**61,327**	(41,576)
Cash Flows from Financing Activities		
Net increase in deposits	**12,641**	27,322
Net (decrease) increase in short-term borrowings	**(29,450)**	11,750
Net decrease in long-term borrowings	**(10,000)**	0
Dividends paid	**(5,836)**	(2,747)
Net Cash (Used in) Provided by Financing Activities	**(32,645)**	36,325
Net Increase in Cash and Cash Equivalents	**32,121**	866
Cash and Cash Equivalents – Beginning	**6,460**	5,594
Cash and Cash Equivalents – Ending	**$38,581**	$ 6,460
Supplementary Cash Flows Information		
Interest paid	**$ 1,301**	$ 2,080
Income taxes paid	**$ 3,250**	$ 825
Loans transferred to foreclosed real estate	**$ 128**	$ 26

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies

General

The accompanying consolidated financial statements include the accounts of Commercial National Financial Corporation (the Corporation) and its wholly-owned subsidiaries, Commercial Bank & Trust of PA (the Bank) and Ridge Properties, Inc. All material intercompany transactions have been eliminated in consolidation.

The Bank operates under a state bank charter and provides full banking services. The Corporation is subject to regulation by the Federal Reserve Board and the Bank is subject to regulation by the Federal Deposit Insurance Corporation and the Pennsylvania Department of Banking. The Bank's primary business consists of taking deposits and granting loans to customers who generally do business in the area of Westmoreland County, Pennsylvania.

As of December 31, 2012, the Corporation employed 111 people in full-time and part-time positions. Fifty-nine (59) employees are represented by the United Auto Workers, Local 1799. In 2008, the Corporation and bargaining unit employees entered into a labor agreement that will expire in February 2014.

The following summary of accounting and reporting policies is presented to aid the reader in obtaining a better understanding of the consolidated financial statements and related financial data of the Corporation and its wholly-owned subsidiaries contained in this report. Such policies conform to generally accepted accounting principles (GAAP) and to general practice within the banking industry.

Estimates

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

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, and the evaluation of other than temporary impairment of securities.

Significant Concentrations of Credit Risk

Most of the Corporation's activities are with customers located within Westmoreland County, Pennsylvania. Note 3 discusses the types of securities that the Corporation invests in. Note 4 discusses the types of lending that the Corporation engages in. The Corporation does not have any significant concentrations to any one industry or customer. Although the Corporation has a diversified loan portfolio, exposure to credit loss can be adversely impacted by downturns in local economic and employment conditions.

Securities

Debt securities are classified as "securities available for sale" and reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of comprehensive income, net of the related deferred income tax effect.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Corporation is generally amortizing these amounts over the contractual life of the loan.

The loans receivable portfolio is segmented into commercial, residential mortgage, and loans to individuals. Commercial loans consist of the following classes: commercial, industrial and other commercial financing, and commercial real estate. The residential loan segment has one class, one- to four-family first lien residential mortgage loans. Loans to individuals consist of one class, which includes all consumer loans to individuals.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans, including impaired loans, generally is either applied against principal or reported as interest income, according to management's judgment as to the collectibility of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally twelve months) and the ultimate collectibility of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for credit losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable is charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Non-residential consumer loans are generally charged off no later than 90 days past due on a contractual basis, earlier in the event of Bankruptcy, or if there is an amount deemed uncollectible. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for credit losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Corporation's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon loans

Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.
2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
3. Nature and volume of the portfolio and terms of loans.
4. Experience, ability, and depth of lending management and staff.
5. Volume and severity of past due, classified and nonaccrual loans as well as other loan modifications.
6. Quality of the Corporation's loan review system, and the degree of oversight by the Corporation's Board of Directors.
7. Existence and effect of any concentrations of credit and changes in the level of such concentrations.
8. Effect of external factors, such as competition and legal and regulatory requirements.

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

The following discusses key risks within each portfolio segment:

Commercial, industrial and other financing – These loans are made to operating companies or manufacturers for the purpose of production, operating capacity, accounts receivable, inventory or equipment financing. Cash flow from the operations of the company is the primary source of repayment for these loans. The condition of the local economy is an important indicator of risk, but there are also more specific risks depending on the industry of the company. Collateral for these types of loans often do not have sufficient value in a distressed or liquidation scenario to satisfy the outstanding debt.

Commercial real estate – These loans are secured by commercial purpose real estate, including both owner occupied properties and investment properties for various purposes such as strip malls and apartment buildings. Individual projects as well as global cash flows are the primary sources of repayment for these loans. The condition of the local economy is an important indicator of risk, but there are also more specific risks depending on the collateral type as well as the business prospects of the lessee, if the project is not owner occupied.

Residential mortgages – These are loans secured by 1-4 family residences, including purchase money mortgages. We currently originate fixed-rate, fully amortizing mortgage loans with maturities of 15 to 30 years. The primary source of repayment for these loans is the income and assets of the borrower. The condition of the local economy, in particular the unemployment rate, is an important indicator of risk for this segment. The state of the local housing market can also have a significant impact on this portfolio, since low demand and/or declining home values can limit the ability of borrowers to sell a property and satisfy the debt.

Loans to individuals – Loans made to individuals may be secured by junior lien positions on a borrower's primary residence or other assets of the borrower, as well as unsecured loans. This segment includes home equity loans, auto loans, and secured or unsecured lines. The primary source of repayment for these loans is the income and assets of the borrower. The condition of the local economy, in particular the unemployment rate, is an important indicator of risk for this segment. The value of the collateral, if there is any, is less likely to be a source of repayment due to less certain collateral values.

Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

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

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

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

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

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

Large groups of smaller balance homogeneous loans are not collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual residential mortgage loans, home equity loans and other consumer loans for impairment disclosures, unless such loans are the subject of a troubled debt restructuring agreement.

Loans whose terms are modified are classified as troubled debt restructurings if the Corporation grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for twelve consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

The allowance for loan loss calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans. Such evaluations for commercial and consumer loans are also made when credit deficiencies arise, such as delinquent loan payments. Credit quality risk ratings include categories of "pass," "special mention," "substandard" and "doubtful." Assets which do not currently expose the insured institution to sufficient risk, warrant classification as "pass." Assets that are not classified as "pass" and possess weaknesses are required to be designated "special mention." If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. An asset is considered

Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

“substandard” if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. “Substandard” assets include those characterized by the “distinct possibility” that the insured institution will sustain “some loss” if the deficiencies are not corrected. Assets classified as “doubtful” have all of the weaknesses inherent in those classified “substandard” with the added characteristic that the weaknesses present make “collection or liquidation in full,” on the basis of currently existing facts, conditions, and values, “highly questionable and improbable.” In addition, Federal regulatory agencies, as an integral part of their examination process, periodically review the Corporation’s allowance for loan losses and may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management’s comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

Off-Balance Sheet Financial Instruments

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

Foreclosed Real Estate

Foreclosed real estate is comprised of property acquired through a foreclosure proceeding or acceptance of a deed in lieu of foreclosure and loans classified as in-substance foreclosure. A loan is classified as in-substance foreclosure when the Bank has taken possession of the collateral regardless of whether formal foreclosure proceedings take place. Foreclosed real estate is initially recorded at fair value, net of estimated selling costs, at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the assets are carried at the lower of cost or fair value minus estimated costs to sell. Revenues and expenses from operations and changes in the valuation allowance are included in other expenses. Foreclosed real estate at December 31, 2012 and 2011 was $528,000 and $647,000, respectively, and is included in other assets.

Intangible Assets

The Corporation has amortizable intangible assets related to core deposit intangibles acquired in 2002 through the acquisition of a branch office. These intangible assets are being amortized on a straight-line basis over a period of ten years. The balance of these amortizable intangible assets at December 31, 2012 was $0 net of accumulated amortization of $975,000, which is included in other assets. Amortization expense of $49,000 was recorded for the year ended December 31, 2012 and 2011 amortization expense was $98,000. Amortization expense is estimated to be $0 in 2013.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation and amortization. For financial statement reporting and income tax purposes, depreciation is computed both on straight-line and accelerated methods over the estimated useful life of the premises and equipment. Charges for maintenance and repairs are expensed as incurred. Amortization is charged over the term of the respective lease or the estimated useful life of the asset, whichever is shorter.

Bank Owned Life Insurance

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

Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Advertising Costs

The Corporation follows the policy of charging the costs of advertising to expense as incurred. Total advertising expense for the years ended December 31, 2012 and 2011 was $120,000 and $154,000, respectively.

Trust Operations

Trust income is recorded on the cash basis, which approximates the accrual basis. Securities and other property held by the Corporation in a fiduciary or agency capacity for customers of the Trust Department are not assets of the Corporation and, accordingly, are not included in the accompanying consolidated financial statements. Assets under management in the trust department totaled $140,252,000 and $141,350,000 at December 31, 2012 and 2011, respectively.

Income Taxes

Deferred income tax assets and liabilities are determined based on the differences between financial statement carrying amounts and the tax basis of existing assets and liabilities. These differences are measured at the enacted tax rates that will be in effect when these differences reverse. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. The Corporation and its subsidiaries file a consolidated federal income tax return.

Earnings per Share

Basic earnings per share have been calculated on the weighted average number of shares outstanding of 2,860,953 in 2012 and 2011. The Corporation currently maintains a simple capital structure, thus there are no dilutive effects on earnings per share.

Treasury Stock

The acquisition of treasury stock is recorded under the cost method. At the date of subsequent reissue, the treasury stock is reduced by the cost of such stock on the average cost basis, with any excess proceeds being credited to retained earnings.

Segment Reporting

The Corporation acts as an independent community financial services provider and offers traditional banking and related financial services to individual, business and government customers. The Corporation offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits, the making of commercial, consumer and mortgage loans and providing other financial services.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial and retail operations of the Corporation. As such, discrete information is not available and segment reporting would not be meaningful.

Statements of Cash Flows

For purposes of reporting cash flows, the Corporation has defined cash and cash equivalents as those amounts included in the balance sheet captions, “Cash and due from banks” and “Interest-bearing deposits with banks.”

Notes to Consolidated Financial Statements

Note 1 – Summary of Significant Accounting Policies (Continued)

Transfers of Financial Assets

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

Restricted Investment in Bank Stock

Federal law requires the Bank, a member institution of the Federal Home Loan Bank system, to hold stock of its district Federal Home Loan Bank (FHLB) according to a predetermined formula. This restricted stock is carried at cost and as of December 31, 2012, consists of the common stock of FHLB of Pittsburgh.

Subsequent Events

The Corporation has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2012 for items that should potentially be recognized or disclosed in the financial statements. The evaluation was conducted through March 25, 2013, the date these financial statements were available to be issued.

New Accounting Standards

In September 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, "Comprehensive Income (Topic 220)—Presentation of Comprehensive Income," under which an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income, in either a single continuous statement of comprehensive income or in two separate but consecutive statements. If a separate statement is preferred, this statement should immediately follow the statement of net income and include components of other comprehensive income and a total for these items along with total comprehensive income. This Update was effective for fiscal years, beginning after December 15, 2011. In December 2011, the FASB issued ASU 2011-12, "Comprehensive Income (Topic 220)—Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." This deferral was made in order to address reclassifications out of accumulated other comprehensive income. All other provisions of ASU 2011-05 were required to be adopted for fiscal beginning after December 15, 2011. The deferral of the aforementioned classifications is also effective for all fiscal periods beginning after December 15, 2011. The adoption of this ASU did not have a material impact on Corporation's financial condition or results of operations. In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." This amendment addresses the previously deferred portions of ASU 2011-05 related to reclassifications out of accumulated other comprehensive income. This amendment requires an entity to provide information about amounts reclassified out of accumulated other comprehensive income ("AOCI") by component. In addition, an entity is required to report the effect of significant reclassifications out of AOCI on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. This update is effective for annual periods beginning after December 15, 2012. The guidance is prospective and management does not believe the adoption of this ASU will have a significant impact on Corporation's financial condition or results of operations.

Note 2 - Cash and Due from Banks

Regulations of the Board of Governors of the Federal Reserve System impose uniform reserve requirements on all depository institutions with transaction accounts and non-personal time deposits. Reserves are maintained in the form of vault cash or a non-interest bearing balance held with the Federal Reserve Bank. The Bank also maintains deposits with the Federal Reserve Bank and other banks for various services such as check clearing.

Note 3 - Securities

The amortized cost and fair values of securities available for sale are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(In Thousands)		
December 31, 2012:				
U.S. Agencies	**$ 16,179**	**$ 0**	**$ (63)**	**$ 16,116**
Obligations of states and political subdivisions	**87,117**	**5,568**	**(273)**	**92,412**
Mortgage-backed securities - GSE	**29,682**	**3,111**	**0**	**32,793**
	$132,978	**$8,679**	**$ (336)**	**$141,321**
December 31, 2011:				
Obligations of states and political subdivisions	$135,525	$ 5,685	$ (257)	$140,953
Mortgage-backed securities - GSE	44,194	4,751	0	48,945
	$179,719	$10,436	$ (257)	$189,898

The amortized cost and fair value of securities at December 31, 2012 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(In Thousands)	
Due within one year	**$ 542**	**$ 553**
Due after one year through five years	**18,016**	**18,236**
Due after five years through ten years	**3,777**	**3,772**
Due after ten years	**110,643**	**118,760**
	$132,978	**$141,321**

Securities with amortized cost and fair values of $25,296,000 and $27,548,000, respectively, at December 31, 2012 and $12,570,000 and $13,866,000 respectively, at December 31, 2011 were pledged to secure public deposits and for other purposes required or permitted by law.

In 2012, the Corporation sold available for sale securities with gross realized gains and losses of $3,499,000 and $181,191, respectively.

There was a gross gain of $9,000, incurred on one municipal bond that was called in 2011.

Note 3 – Securities (Continued)

The following table shows the Corporation's gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2012 and 2011:

(In Thousands)
December 31, 2012

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Agencies	$16,116	$ (63)	$ 0	$ 0	$16,116	$(63)
Obligations of states and political subdivisions	12,109	(273)	0	0	12,109	(273)
	$28,225	$(336)	$ 0	$ 0	$28,225	$(336)

(In Thousands)
December 31, 2011

Obligations of states and political subdivisions	$12,783	$(257)	$ 0	$ 0	$12,783	$(257)

The Corporation reviews its position quarterly to determine if there is Other-Than-Temporary Impairment (OTTI) on any of its securities. All of the Corporation's securities are debt securities and we assess whether OTTI is present when the fair value of a security is less than its amortized cost basis. The Corporation monitors the credit ratings of all securities for downgrades as well as any other indication of OTTI condition. As of December 31, 2012, there were sixteen (16) U.S. agency bonds and nine (9) municipal bonds in an unrealized loss position. These unrealized losses are considered to be temporary impairments. The decline in the value of these debt securities is due only to interest rate fluctuations and not any deterioration in credit quality. As a result, the Corporation currently expects full payment of contractual cash flows, including principal from these securities. Management has the intent and ability to hold these securities until market recovery or maturity, therefore none of the unrealized losses on securities are deemed to be other than temporary.

At December 31, 2012, all debt securities with temporarily impaired losses have been rated by Moody's and/or S&P with an "A-" or better debt rating.

Subsequent Event

In January 2013 the Corporation purchased $4.0 million in U.S. agency bonds. The Corporation has also purchased municipal bonds at a cost of $18.7 million through March 25, 2013 and has committed to purchase $16.0 million of municipal bonds in late March and April 2013.

Notes to Consolidated Financial Statements

Note 4 - Loans

Loans are summarized as follows:

	December 31, 2012	December 31, 2011
	(In Thousands)	
Commercial		
Commercial , Industrial & Other	**$ 40,221**	$ 35,751
Commercial real estate	**63,420**	64,202
Residential mortgages	**44,613**	58,992
Loans to Individuals	**20,632**	20,441
	$168,886	$179,386

Note 5 – Allowance for Loan Loss

The allowance for loan loss calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include categories of "pass," "special mention," "substandard" and "doubtful." Assets which do not currently expose the insured institution to sufficient risk, warrant classification as "pass." Assets that are not classified as "pass" and possess weaknesses are required to be designated "special mention." If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. An asset is considered "substandard" if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. "Substandard" assets include those characterized by the "distinct possibility" that the insured institution will sustain "some loss" if the deficiencies are not corrected. Assets classified as "doubtful" have all of the weaknesses inherent in those classified "substandard" with the added characteristic that the weaknesses present make "collection or liquidation in full," on the basis of currently existing facts, conditions, and values, "highly questionable and improbable."

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Corporation's internal risk rating system as of December 31, 2012:

(Dollars in Thousands)

	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Commercial,					
Industrial & Other	$ 39,997	$ 112	$ 112	$ 0	$ 40,221
Commercial real estate	49,904	6,970	6,546	0	63,420
Residential mortgages	44,100	395	118	0	44,613
Loans to Individuals	20,477	155	0	0	20,632
Total	$154,478	$ 7,632	$ 6,776	$ 0	$168,886

Notes to Consolidated Financial Statements

Note 5 – Allowance for Loan Loss (Continued)

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

(Dollars in Thousands)

	Pass	Special Mention	Substandard	Doubtful	Total
Commercial					
Commercial, Industrial & Other	$ 35,560	$ 126	$ 65	$ 0	$ 35,751
Commercial real estate	49,470	10,749	3,983	0	64,202
Residential mortgages	58,450	407	135	0	58,992
Loans to Individuals	20,283	158	0	0	20,441
Total	$163,763	$ 11,440	$ 4,183	$ 0	$179,386

Past due loans are reviewed on a monthly basis to identify loans for non-accrual status. The Corporation generally places a loan on non-accrual status and discontinues interest accruals when principal or interest is due and has remained unpaid for 90 days. When a loan is placed on non-accrual status, all unpaid interest recognized in the current year is reversed and interest accrued in prior years is charged to the allowance for loan losses. Non-accrual loans may not be restored to accrual status until all delinquent principal and interest have been paid and the ultimate collectability of the remaining principal and interest is reasonably assured.

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2012:

(Dollars in Thousands)

	30-89 Days Past Due	≥90 Days Past Due and Still Accruing	Non-Accrual	Total Past Due	Current	Total Loans
Commercial						
Commercial, Industrial & Other	$ 32	$ 0	$ 0	$ 32	$ 40,189	$ 40,221
Commercial real estate	251	0	0	251	63,169	63,420
Residential mortgages	0	0	12	12	44,601	44,613
Loans to individuals	7	0	5	12	20,620	20,632
Total	$ 290	$ 0	$ 17	$ 307	$168,579	$168,886

Notes to Consolidated Financial Statements

Note 5 – Allowance for Loan Loss (Continued)

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

(Dollars in Thousands)

	30-89 Days Past Due	≥90 Days Past Due and Still Accruing	Non-Accrual	Total Past Due	Current	Total Loans
Commercial						
Commercial, Industrial & Other	$ 60	$ 0	$ 0	$ 60	$ 35,691	$ 35,751
Commercial real estate	258	0	0	258	63,944	64,202
Residential mortgages	0	0	76	76	58,916	58,992
Loans to individuals	7	0	27	34	20,407	20,441
Total	$ 325	$ 0	$ 103	$ 428	$178,958	$179,386

The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2012.

(Dollars in Thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial					
Commercial, Industrial & Other	$ 0	$ 0	$ 0	$ 28	$ 2
Commercial real estate	0	0	0	258	13
Residential mortgages	0	0	0	23	2
Loans to Individuals	0	0	0	0	0
Subtotal	0	0	0	309	17
With an allowance recorded:					
Commercial					
Commercial, Industrial & Other	0	0	0	0	0
Commercial real estate	0	0	0	0	0
Residential mortgages	0	0	0	0	0
Loans to Individuals	0	0	0	0	0
Subtotal	0	0	0	0	0
Total	$ 0	$ 0	$ 0	$ 309	$ 17

Notes to Consolidated Financial Statements

Note 5 – Allowance for Loan Loss (Continued)

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

(Dollars in Thousands)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial					
Commercial, Industrial & Other	$ 29	$ 29	$ 0	$ 36	$ 3
Commercial real estate	278	278	0	296	19
Residential mortgages	29	29	0	34	3
Loans to Individuals	0	0	0	0	0
Subtotal	336	336	0	366	25
With an allowance recorded:					
Commercial					
Commercial, Industrial & Other	0	0	0	0	0
Commercial real estate	0	0	0	0	0
Residential mortgages	0	0	0	0	0
Loans to Individuals	0	0	0	0	0
Subtotal	0	0	0	0	0
Total	$ 336	$ 336	$ 0	$ 366	$ 25

The following table provides detail related to the allowance for loan losses:

Twelve-months ended
December 31, 2012
(Dollars in Thousands)

	Commercial, Industrial & Other	Commercial Real Estate	Residential Mortgages	Loans to Individuals	Unallocated	Total
Allowance for credit losses:						
Beginning Balance	$ 155	$ 1,360	$ 94	$ 25	$ 39	$ 1,673
Charge-offs	0	(19)	(14)	(10)	0	(43)
Recoveries	0	0	0	19	0	19
Provision	5	(36)	(9)	(1)	41	0
Ending Balance	$ 160	$ 1,305	$ 71	$ 33	$ 80	$ 1,649

Notes to Consolidated Financial Statements

Note 5 – Allowance for Loan Loss (Continued)

Twelve-months ended
December 31, 2011
(Dollars in Thousands)

	Commercial, Industrial & Other	Commercial Real Estate	Residential Mortgages	Loans to Individuals	Unallocated	Total
Allowance for credit losses:						
Beginning Balance	$ 107	$ 1,378	$ 110	$ 31	$ 60	$ 1,686
Charge-offs	0	0	(3)	(10)	0	(13)
Recoveries	0	0	0	0	0	0
Provision	48	(18)	(13)	4	(21)	0
Ending Balance	$ 155	$ 1,360	$ 94	$ 25	$ 39	$ 1,673

The following table provides detail related to the allowance for loan losses and recorded investment in financing receivables as of December 31, 2012:

(Dollars in Thousands)

	Commercial, Industrial & Other	Commercial Real Estate	Residential Mortgages	Loans to Individuals	Unallocated	Total
Allowance for credit losses:						
Ending balance: individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Ending balance: collectively evaluated for impairment	$ 160	$ 1,305	$ 71	$ 33	$ 80	$ 1,649
Ending balance: loans acquired with deteriorated credit quality	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Loans receivable:						
Ending Balance	$40,221	$63,420	$44,613	$20,632	$ 0	$168,886
Ending balance: individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Ending balance: collectively evaluated for impairment	$40,221	$63,420	$44,613	$20,632	$ 0	$168,886
Ending balance: loans acquired with deteriorated credit quality	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0

Notes to Consolidated Financial Statements

Note 5 – Allowance for Loan Loss (Continued)

The following table provides detail related to the allowance for loan losses and recorded investment in financing receivables as of December 31, 2011:

(Dollars in Thousands)

	Commercial, Industrial & Other	Commercial Real Estate	Residential Mortgages	Loans to Individuals	Unallocated	Total
Allowance for credit losses:						
Ending balance: individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Ending balance: collectively evaluated for impairment	$ 155	$ 1,360	$ 94	$ 25	$ 39	$ 1,673
Ending balance: loans acquired with deteriorated credit quality	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Loans receivable:						
Ending Balance	$35,751	$64,202	$58,992	$20,441	$ 0	$179,386
Ending balance: individually evaluated for impairment	$ 29	$ 278	$ 29	$ 0	$ 0	$ 336
Ending balance: collectively evaluated for impairment	$35,722	$63,924	$58,963	$20,441	$ 0	$179,050
Ending balance: loans acquired with deteriorated credit quality	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0

The Corporation has adopted ASU No. 2011-02, *A Creditor's Determination of Whether A Restructuring Is a Troubled Debt Restructuring*, which clarifies when a loan modification or restructuring is considered a troubled debt restructuring (TDR). The Corporation has determined that as of and for the periods ending December 31, 2012 and December 31, 2011, there were no loans considered as troubled debt restructures.

Notes to Consolidated Financial Statements

Note 6 - Financial Instruments with Off-Balance Sheet Risk

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amount of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments. The Corporation does not issue any other instruments with significant off-balance-sheet risk.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contract or notional amount of those instruments. The Corporation uses the same credit policies in making such commitments and conditional obligations as it does for on-balance-sheet instruments. The following table identifies the contract or notional amount of those instruments:

	December 31,	
	2012	**2011**
	(In Thousands)	
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit, including unused lines of credit	**$35,319**	$28,620
Standby letters of credit	**368**	232

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Outstanding letters of credit written are conditional commitments issued by the Corporation to secure the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Corporation requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at December 31, 2012 was $368,000 and the approximate value of underlying collateral upon liquidation that would be expected to cover this maximum potential exposure was $85,000. The amount of the liability as of December 31, 2012 and 2011 for guarantees under standby letters of credit issued is not material.

Notes to Consolidated Financial Statements

Note 7 - Premises and Equipment

The composition of premises and equipment at December 31, 2012 and 2011 is as follows:

	2012	2011
	(In Thousands)	
Land	**$ 437**	$ 437
Premises	**5,815**	5,815
Leasehold improvements	**301**	301
Furniture and equipment	**6,018**	5,927
	12,571	12,480
Accumulated depreciation and amortization	**(9,435)**	(9,395)
	$ 3,136	$ 3,085

Depreciation and amortization expense was $335,000 and $332,000 for the years ended December 31, 2012 and 2011, respectively.

The Corporation rents offices under operating leases that expire through 2019. Lease expense amounted to $141,000 in 2012 and $135,000 in 2011. Operating lease obligations at December 31, 2012 are as follows (in thousands):

2013	**$143**
2014	**145**
2015	**138**
2016	**119**
2017	**55**
Thereafter	**85**
	$685

Note 8 - Deposits

Deposits at December 31, 2012 and 2011 are detailed as follows:

	2012	2011
	(In Thousands)	
Non-interest bearing accounts	**$103,437**	$ 89,690
Savings accounts	**64,604**	60,117
NOW accounts	**26,663**	28,245
Money market accounts	**40,314**	40,279
Time deposits	**81,439**	85,485
	$316,457	$303,816

Interest bearing deposits include time deposits issued in denominations of $100,000 or more which amounted to $35,231,000 and $34,614,000 at December 31, 2012 and 2011 respectively.

Notes to Consolidated Financial Statements

Note 8 – Deposits (Continued)

Time deposits at December 31, 2012 had the following scheduled maturities (in thousands):

2013	**$50,982**
2014	**11,672**
2015	**9,755**
2016	**5,278**
2017	**3,500**
Thereafter	**252**
	$81,439

Note 9 - Short-Term Borrowings

There were no short-term borrowings at December 31, 2012. The December 31, 2011 borrowings consisted of $1,350,000 of federal funds purchased and $28,100,000 of FHLB borrowings.

The outstanding balances and related information of short-term borrowings are summarized as follows**:**

	Years Ended December 31,	
	2012	**2011**
	(Dollars in Thousands)	
Average balance during the year	**$ 7,567**	$24,833
Average interest rate during the year	**0.19%**	0.24%
Maximum month-end balance	**$41,250**	$36,275
Balance at year-end	**$ 0**	$29,450
Weighted average interest rate at end of the year	**0.00%**	0.15%

At December 31, 2012, the Corporation had approved but unused funding availability from lines of credit of $20,000,000.

Note 10 - Long-Term Borrowings

Long-term borrowings outstanding were zero at December 31, 2012 and $10,000,000 at December 31, 2011. The $10,000,000 outstanding as of December 31, 2011, represents one advance with an interest rate of 2.34% and a maturity date of January 3, 2012. Advances from the FHLB of Pittsburgh are secured by the Bank's stock in the FHLB of Pittsburgh and qualifying loans. The maximum remaining borrowing capacity from the FHLB at December 31, 2012 is approximately $103,000,000.

Note 11 - Employee Benefit Plans

The Corporation sponsors an employee profit sharing plan available to all employees with at least one year of service. The Corporation contributes to the plan, as determined by the Board of Directors, in an amount not to exceed 15% of compensation of eligible participants. For the years ended December 31, 2012 and 2011, the amount was 5% of compensation of eligible participants. The Corporation also has a supplemental retirement plan for certain retired employees. The expense for the employee benefit plans was $260,000 for the years ended December 31, 2012 and 2011.

Note 12 - Comprehensive Income

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

Notes to Consolidated Financial Statements

Note 12 - Comprehensive Income (Continued)

The components of other comprehensive income and related tax effects for the years ended December 31, 2012 and 2011 are as follows:

	2012	2011
	(In Thousands)	
Unrealized gains		
On securities available for sale	**$1,481**	$3,901
Reclassification adjustment for gains realized in income	**(3,317)**	(9)
Net Unrealized Gains (Losses)	**(1,836)**	3,892
Tax (benefit) effect	**(624)**	1,323
Net of Tax Amount	**$(1,212)**	$2,569

Note 13 - Income Taxes

The components of the net deferred tax liability at December 31, 2012 and 2011 are as follows:

	2012	2011
	(In Thousands)	
Allowance for loan losses	**$ 340**	$ 340
Accrued benefits	**15**	15
Intangible assets	**100**	105
Other	**13**	31
Total Deferred Tax Assets	**468**	491
Deferred loan fees	**59**	62
Securities accretion	**20**	35
Unrealized net gain on securities available for sale	**2,837**	3,528
Depreciation	**364**	343
Total Deferred Tax Liabilities	**3,280**	3,968
Net Deferred Tax Liability	**$(2,812)**	$(3,477)

The income tax provision for the years ended December 31, 2012 and 2011 is summarized as follows:

	2012	2011
	(In Thousands)	
Current	**$1,625**	$1,355
Deferred	**26**	(96)
	$1,651	$1,259

Note 13 - Income Taxes (Continued)

The tax provision for financial reporting purposes differs from the amount computed by applying the statutory federal income tax rate of 34% to income before income taxes. The differences for the years ended December 31, 2012 and 2011 are as follows:

	2012		2011	
	(Dollars in Thousands)			
Tax at statutory rates	**$3,032**	34.0%	$2,711	34.0%
Increase (decrease) resulting from:				
Tax-exempt income	**(1,280)**	(14.4)	(1,370)	(17.2)
Non-deductible interest expense	**47**	0.5	76	1.0
Increase in investment in life insurance	**(164)**	(1.8)	(168)	(2.1)
Other	**16**	0.2	10	0.1
	$1,651	18.5%	$1,259	15.8%

The Corporation periodically reviews its tax position and applies a "more likely than not" recognition threshold for all tax uncertainties. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Corporation establishes a valuation allowance when it is more likely than not that the Corporation will not be able to realize the benefit of the deferred tax assets or when future deductibility is uncertain. Periodically, the valuation allowance is reviewed and adjusted based on management's assessment of realizable deferred tax assets. The Corporation had no unrecognized tax positions at December 31, 2012 and 2011. The Corporation is no longer subject to U.S. federal income tax examinations for the years prior to 2010. With limited exception, the Corporation is no longer subject to state income tax examinations for years prior to 2009.

Note 14 - Fair Value of Financial Instruments

FASB ASC-820 establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FASB ASC-820 are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

Notes to Consolidated Financial Statements

Note 14 - Fair Value of Financial Instruments (Continued)

For assets measured at fair value on a recurring basis, the fair value measurement by level within the fair value hierarchy are as follows:

	(Level 1) Quoted Prices In active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2012:		**(In Thousands)**	
U.S. Agencies	**$ 0**	**$ 16,116**	**$ 0**
Obligations of states and political subdivisions	**$ 0**	**92,412**	**$ 0**
Mortgage-backed securities	**0**	**32,793**	**0**
	$ 0	**$141,321**	**$ 0**
December 31, 2011:			
Obligations of states and political subdivisions	$ 0	$140,953	$ 0
Mortgage-backed securities	0	48,945	0
	$ 0	$189,898	$ 0

We may be required to measure certain other financial assets at fair value on a nonrecurring basis. These adjustments to fair value usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets. The Level 3 disclosures shown below represent the carrying value of loans for which adjustments are primarily based on the appraised value of collateral or the present value of expected future cash flows, which often results in significant management assumptions and input with respect to the determination of fair value. There were no realized or unrealized gains or losses relating to Level 3 financial assets and liabilities measured on a nonrecurring basis for the years ended December 31, 2012 and December 31, 2011.

For assets measured at fair value on a nonrecurring basis, the fair value measurement by level within the fair value hierarchy used are as follows:

	(Level 1) Quoted Prices In active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
December 31, 2012:		**(In Thousands)**	
Impaired Loans	**$ 0**	**$ 0**	**$ 0**
Other Real Estate Owned	**$ 0**	**$ 0**	**$ 0**
December 31, 2011:			
Impaired Loans	$ 0	$ 0	$ 0
Other Real Estate Owned	$ 0	$ 0	$ 8

Note 14 - Fair Value of Financial Instruments (Continued)

There were no impaired loans at December 31, 2012 and December 31, 2011, which were measured using the fair value of the collateral less estimated costs to sell for collateral-dependent loans.

Other real estate owned at December 31, 2011, which is measured using the fair value of the collateral less estimated costs to sell, had a carrying amount of $8,000.

ASC 825-10-65, Transition Related to FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments," require disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis. The methodologies for estimating the fair value of financial assets that are measured at fair value on a non-recurring basis are as discussed above. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring basis are discussed below. The methodologies for other financial assets and financial liabilities are also discussed below.

The following methods and assumptions were used by the Corporation in estimating financial instrument fair values:

Cash and Short-Term Investments

The carrying amounts for cash and short-term investments approximate the estimated fair values of such assets.

Securities Available for Sale

The Corporation utilizes a third party in determining the fair values for securities held as available for sale. For the Corporation's U.S. agency bonds, the third party utilizes benchmark yields, reported trades, broker/dealer quotes, issuer spreads and reference data including market research publications. For the Corporation's municipal bonds, the third party utilizes benchmark yields, reported trades, broker/dealer quotes, issuer spreads, Municipal Market Data benchmarks (MMD) and reference data including market research publications. To determine fair values for the Corporation's GSE mortgage backed securities, the model uses bench mark yields, reported trades, broker/dealer quotes, issuer spreads, TBA prices, monthly payment information and reference data including market research publications.

Restricted Investments in Bank Stock

The carrying amounts of restricted investments in bank stock approximate the estimated fair value of such assets.

Loans Receivable

The estimated fair values of our fixed rate loans are estimated by discounting the future cash flows using interest rates currently offered for loans with similar terms to borrowers of similar credit quality. Fair values of variable rate loans subject to frequent re-pricing and which entail no significant credit risk are based on the carrying values.

Deposits

For deposits which are payable on demand at the reporting date, representing all deposits other than time deposits, management estimated that the carrying value of such deposits is a reasonable estimate of fair value. Fair values of time deposits are estimated by discounting the future cash flows using interest rates currently being offered and a schedule of aggregate expected maturities.

Short-Term Borrowings

The carrying amounts for short-term borrowings approximate the estimated fair value of such liabilities.

Notes to Consolidated Financial Statements

Note 14 - Fair Value of Financial Instruments (Continued)

Long-Term Borrowings

Fair values of long-term borrowings are estimated by discounting the future cash flows using interest rates currently available for borrowings with similar terms and maturity.

Accrued Interest Receivable and Payable

The carrying amount of accrued interest receivable and payable is considered a reasonable estimate of fair value.

Off-Balance Sheet Instruments

The fair value of commitments to extend credit and for outstanding letters of credit is estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms and present credit worthiness of the counterparties.

The carrying amounts and fair values of the Corporation's financial instruments as of December 31, 2012 are presented in the following table:

(Dollars in Thousands)

	Carrying Amount	Fair Value Estimate	(Level 1) Quoted Prices In Active Markets For Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs
Financial Assets:					
Cash and equivalents	**$ 38,581**	**$ 38,581**	**$ 38,581**	**$ 0**	**$ 0**
Securities available for sale	**141,321**	**141,321**	**0**	**141,321**	**0**
Restricted investment in bank stock	**2,506**	**2,506**	**0**	**2,506**	**0**
Net loans receivable	**167,237**	**172,734**	**0**	**0**	**172,734**
Accrued interest receivable	**1,481**	**1,481**	**0**	**1,481**	**0**
Financial liabilities:					
Deposits	**$316,457**	**$312,451**	**$ 0**	**$312,451**	**$ 0**
Short-term borrowings	**0**	**0**	**0**	**0**	**0**
Long-term borrowings	**0**	**0**	**0**	**0**	**0**
Accrued interest payable	**167**	**167**	**0**	**167**	**0**
Off-balance sheet financial instruments	**0**	**0**	**0**	**0**	**0**

Note 14 - Fair Value of Financial Instruments (Continued)

The carrying amounts and fair values of the Corporation's financial instruments as of December 31, 2011 are presented in the following table:

	December 31, 2011	
	Carrying Amount	Fair Value
	(In Thousands)	
Financial assets:		
Cash and short-term investments	$ 6,460	$ 6,460
Securities available for sale	189,898	189,898
Restricted investments in bank stock	3,534	3,534
Net loans receivable	177,713	183,458
Accrued interest receivable	2,545	2,545
Financial liabilities:		
Deposits	$303,816	$299,593
Short-term borrowings	29,450	29,450
Long-term borrowings	10,000	10,000
Accrued interest payable	281	281
Off-balance sheet financial instruments	0	0

Note 15 - Related Party Transactions

Some of the Corporation's or the Bank's directors, principal officers, and their related interests had transactions with the Bank in the ordinary course of business. All loans and loan commitments in such transactions were made on substantially the same terms, including collateral and interest rates, as those prevailing at the time for comparable transactions with others. In the opinion of management, these transactions with related parties do not involve more than normal risk of collectibility or present other unfavorable features. It is anticipated that further such extensions of credit will be made in the future. The aggregate amount outstanding to these directors and principal officers was approximately $402,000 and $285,000 at December 31, 2012 and 2011, respectively. During 2012, there were $237,000 in advances and repayments totaled $120,000.

Notes to Consolidated Financial Statements

Note 16 - Capital Requirements and Regulatory Restrictions

The Bank is subject to legal limitations on the amount of dividends that can be paid to the Corporation. The Pennsylvania Banking Code restricts the payment of dividends, generally to the extent of its retained earnings.

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

Quantitative measures established by regulation to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the tables below) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 Capital (as defined) to average assets (as defined). Management believes, as of December 31, 2012, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2012, the most recent notification from the regulatory agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since those notifications that management believes have changed those categories.

The Corporation's capital ratios are substantially the same as the Bank's capital ratios disclosed below.

The following table presents the risk-based and leverage capital amounts and ratios at December 31, 2012 and 2011 for Commercial Bank & Trust of PA:

	Actual		**For Capital Adequacy Purposes**		**To be Well Capitalized Under Prompt Corrective Action Provisions**	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
			(Dollars in Thousands)			
As of December 31, 2012						
Total capital (to risk-weighted assets)	**$48,699**	**23.9%**	**$≥16,282**	**≥8.0%**	**$≥20,351**	**≥10.0%**
Tier 1 capital (to risk-weighted assets)	**47,050**	**23.1**	**≥ 8,141**	**≥4.0**	**≥12,211**	**≥ 6.0**
Tier 1 capital (to average assets)	**47,050**	**13.1**	**≥14,384**	**≥4.0**	**≥17,980**	**≥ 5.0**
As of December 31, 2011						
Total capital (to risk-weighted assets)	$47,328	21.6%	$≥17,506	≥8.0%	$≥21,882	≥10.0%
Tier 1 capital (to risk-weighted assets)	45,655	20.9	≥ 8,753	≥4.0	≥13,130	≥ 6.0
Tier 1 capital (to average assets)	45,655	11.8	≥15,531	≥4.0	≥19,414	≥ 5.0

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