

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

ORRSTOWN FINANCIAL SERVICES INC
Form DEF 14A
March 19, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

- Filed by the Registrant [X]
Filed by a Party other than the Registrant []
Check the appropriate box:
 [X] Preliminary Proxy Statement [] CONFIDENTIAL, FOR USE OF THE
COMMISSION ONLY (AS PERMITTED BY RULE 14A-
6(E) (2))
 [] Definitive Proxy Statement
 [] Definitive Additional Materials
 [] Soliciting Material Pursuant to Section 240.14a-11(c) or Section 240.14a-
12

ORRSTOWN FINANCIAL SERVICES, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)
Payment of Filing Fee (Check the appropriate box):

- [X] No fee required
 [] Fee computed on table below per Exchange Act Rules 14a-6(i) (4) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed
pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the
filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

- [] Fee paid previously with preliminary materials.
 [] Check box if any part of the fee is offset as provided by Exchange Act
Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid
previously. Identify the previous filing by registration statement number, or
the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No. :

(3) Filing Party:

(4) Date Filed:

[Orrstown Financial Services, Inc. Logo]

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

Orrstown Financial Service, Inc.
77 East King Street
Shippensburg, PA 17257

April 2, 2004

Dear Shareholder,

You are invited to attend the 2004 Annual Meeting of Shareholders of Orrstown Financial Services, Inc. to be held on Tuesday, May 4, 2004 beginning at 9:00 a.m. The meeting will be held in the King Street Conference Room of the Orrstown Bank Administrative Center located at 77 East King Street, Shippensburg, Pennsylvania.

A Notice of the Annual Meeting, Proxy Statement and Proxy are enclosed with this mailing. You are encouraged to review this material and complete, sign, date and return the Proxy in the postage-paid envelope provided. It is important for you to return the Proxy regardless of whether you plan to attend the Annual Meeting. I also invite you to review the enclosed Annual Report, which includes details of the success achieved by your company during 2003.

Sincerely,

Kenneth R. Shoemaker
President and Chief Executive Officer

[Orrstown Financial Services, Inc. Logo]

Orrstown Financial Services, Inc.
77 East King Street
Shippensburg, Pennsylvania 17257

April 2, 2004

Notice of Annual Meeting of Shareholders

The Annual Meeting of Shareholders of Orrstown Financial Services, Inc. will be held on Tuesday, May 4, 2004, at 9:00 a.m., in the King Street Conference Room of the Orrstown Bank Administrative Center located at 77 East King Street, Shippensburg, Pennsylvania, to consider and take action on the following matters:

1. Elect three directors to Class B for three year terms expiring in 2007;

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

2. Approve an amendment to the Articles of Incorporation to increase the number of authorized shares of the Company's common stock from 10 million shares to 50 million shares; and
3. Transact such other business as may properly come before the meeting.

Your Board of Directors recommends a vote "FOR" the election as directors to Class B of the three nominees listed in the enclosed Proxy Statement and a vote "FOR" the proposed amendment to the Articles of Incorporation to increase the number of authorized shares of common stock from 10 million shares to 50 million shares.

This Notice of Annual Meeting of Shareholders, the Proxy Statement and the enclosed Proxy card are being sent to shareholders of record at the close of business on March 25, 2004.

Denver L. Tuckey
Secretary

TABLE OF CONTENTS	Page
Annual Meeting Information	1
Who is entitled to vote?	1
On what am I voting?	1
How does the Board of Directors recommend I vote on the proposals?	2
How do I vote?	2
What is a quorum?	2
What vote is required to approve each proposal?	2
Who will count the vote?	3
What is the deadline for shareholder proposals for next year's Annual Meeting?	3
How are proxies being solicited?	3
Share Ownership of Certain Beneficial Owners	3
Share Ownership of Management	4
Section 16(a) Beneficial Ownership Reporting Compliance	5
Item 1- Election of Directors	5
Biographical Summaries of Nominees and Directors	6
Executive Officers	8
Board Committees and Meeting Attendance	8
Audit Committee Report	10
Compensation of Directors	11
Report on Executive Compensation	12
Company Performance	14
Executive Compensation	16
Summary of Compensation	16
Option Grants in 2003	17
Aggregated Option Exercises in 2003 and Year-end Option Values	18

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

Retirement Benefits	18
Change in Control Agreement	19
Transactions with Management	20
Independent Certified Public Accountants	20
Shareholder Communications with the Board of Directors	21
Item 2 - Approve Amendment to Articles of Incorporation	21
Proposed Amendment	21
Reasons for the Proposed Increase in Common Shares	22
Effective Date	23
Vote Required	23
Board Recommendation	23

ORRSTOWN FINANCIAL SERVICES, INC.
77 East King Street
Shippensburg, Pennsylvania 17257

PROXY STATEMENT

Annual Meeting Information

This proxy statement contains information about the Annual Meeting of Shareholders of Orrstown Financial Services, Inc. to be held Tuesday, May 4, 2004, beginning at 9:00 a.m., in the King Street Conference Room of the Orrstown Bank Administrative Center located at 77 East King Street, Shippensburg, Pennsylvania, and at any adjournments or postponements of the meeting. The proxy statement was prepared at the direction of the Company's Board of Directors to solicit your proxy for use at the Annual Meeting. It will be mailed to shareholders on or about April 2, 2004.

Who is entitled to vote?

Shareholders owning Company common stock on March 25, 2004 are entitled to vote at the Annual Meeting or any adjournment or postponement of the meeting. Each shareholder has one vote per share on all matters to be voted on. On March 1, 2004 there were 5,097,249 shares of Common Stock outstanding.

On what am I voting?

You will be asked to:

1. Elect 3 directors to Class B for three year terms expiring in 2007; and
2. Approve an amendment to the Articles of Incorporation to increase the number of authorized shares of common stock from 10 million shares to 50 million shares.

The Board of Directors is not aware of any other matters to be presented for action at the meeting. If any other matter requiring a vote of the shareholders would be presented at the meeting, the proxies will vote according to the directions of Company management.

How does the Board of Directors recommend I vote on the proposals?

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

The Board of Directors recommends:

1. A vote FOR the election of each of the three nominees as directors to Class B; and
2. A vote FOR approval of the amendment to the Articles of Incorporation to increase the number of authorized shares of common stock from 10 million shares to 50 million shares.

How do I vote?

Sign and date each proxy form you receive and return it in the postage-paid envelope provided. If you sign your proxy form but do not mark your choices, your proxies will vote for:

- * the three persons nominated for election as directors to Class B; and
- * approval of the amendment to the Articles of Incorporation to increase the number of authorized shares of common stock from 10 million shares to 50 million shares.

You may revoke your proxy at any time before it is exercised. To do so, you must give written notice of revocation to the Secretary, Orrstown Financial Services, Inc., 77 East King Street, Shippensburg, Pennsylvania 17257, submit another properly signed proxy with a more recent date, or vote in person at the meeting.

What is a quorum?

A "quorum" is the presence at the meeting, in person or by proxy, of the holders of a majority of the outstanding shares. There must be a quorum for the meeting to be held. Abstentions are counted for purposes of determining the presence or absence of a quorum, but are not considered a vote cast under Pennsylvania law. Brokers holding shares in street name for their customers generally are not entitled to vote on certain matters unless they receive voting instructions from their customers. Such shares for which brokers have not received voting instructions from their customers are called "broker non-votes." Under Pennsylvania law broker non-votes will be counted to determine if a quorum is present with respect to any matter to be voted upon by shareholders at the meeting only if such shares have been voted at the meeting on another matter other than a procedural motion.

What vote is required to approve each proposal?

In the election of directors, the three nominees for election as directors to Class B receiving the highest number of votes will be elected to the Board of Directors.

The affirmative vote a majority of the votes cast is required to approve the amendment to the Articles of Incorporation to increase the number of authorized shares of common stock from 10 million shares to 50 million shares.

Who will count the vote?

The Judges of Election appointed by the Board of Directors will count the votes cast in person or by proxy at the Annual Meeting.

What is the deadline for shareholder proposals for next year's Annual Meeting?

Shareholders may submit proposals on matters appropriate for shareholder

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

action at future annual meetings by following the rules of the Securities and Exchange Commission and the Company's By-laws. Proposals intended for inclusion in next year's proxy statement and proxy card must be received by the Company not later than November 30, 2004. All proposals should be addressed to the Secretary of the Company.

How are proxies being solicited?

In addition to solicitation by mail, the officers, directors and employees of the Company may, without additional compensation, solicit proxies by telephone or personal interview. Brokers and other custodians, nominees and fiduciaries will be requested to forward soliciting material to the beneficial owners of Common Stock held by such persons and will be reimbursed by the Company for their expenses. The cost of soliciting proxies for the Annual Meeting will be born by the Company.

Share Ownership of Certain Beneficial Owners

The Company does not know of any person who beneficially owned more than 5% of the Company's Common Stock on March 1, 2003, except as shown in the following table:

Name and address of Beneficial Owner	Common Stock Beneficially Owned	Percent of Class
Orrstown Bank 77 East King Street Shippensburg, PA 17257	799,437 (1)	15.68%

(1) Shares held directly by the Bank, or by way of its nominees, in its trust department as fiduciary for certain trusts, estates and agency accounts that beneficially own the shares. The Bank shares voting power as to 419,327 of these shares but, as a matter of policy, votes such shares solely in accordance with the directions, if any, of the persons with whom it shares voting power. The Bank has sole voting power as to 138,991 of these shares and, subject to the provisions of governing instruments and/or in accordance with applicable provisions of fiduciary law, may vote such shares in what it reasonably believes to be the best interest of the respective trust, estate or agency account for which it holds such shares. As a matter of policy, however, the Bank does not vote shares for which it has sole voting power. The Bank does not have the right to vote the remaining 241,119 shares and disclaims beneficial ownership of such shares.

Share Ownership of Management

The following table shows the number of shares of Company Common Stock beneficially owned by each incumbent director, each nominee and each executive officer named in the Summary Compensation Table appearing on page 15, and by all of the incumbent directors, nominees and executive officers of the Company as a group, as of March 1, 2004. Except as otherwise indicated, sole voting power and sole investment power with respect to the shares shown in the table are held either by the individual alone or by the individual together with his or her spouse.

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

Name	Common Stock Beneficially Owned (1) (2)
Anthony F. Ceddia	4,473
Jeffrey W. Coy	29,194
Jeffrey W. Embly	18,332
Bradley S. Everly	17,152
Philip E. Fague	22,183
Stephen C. Oldt	19,566
Andrea Pugh	19,217
Gregory Rosenberry	34,110
Kenneth R. Shoemaker	50,532
Glenn W. Snoke	11,479

Name	Common Stock Beneficially Owned (1) (2)
Denver L. Tuckey	10,612
John S. Ward	4,811
Joel R. Zullinger	27,071
Directors, nominees and executive officers as a group (17 persons including those named above)	293,493

(1) On March 1, 2004, none of the individuals named in the above table beneficially owned more than 1% of the outstanding shares of Company Common Stock. On that date, all of the incumbent directors, nominees, and executive officers as a group beneficially owned approximately 5.63% of the outstanding shares of Company Common Stock. Fractional shares beneficially owned by such individuals have been rounded down to the number of whole shares beneficially owned.

(2) The amounts shown include the following amounts of Common Stock that the indicated individuals and group have the right to acquire within 60 days of March 1, 2004 through the exercise of stock options granted pursuant to the Company's stock option plans: Mr. Ceddia, 2,166; Mr. Coy, 2,706; Mr. Embly, 12,610; Mr. Everly, 12,238; Mr. Fague, 15,044; Mr. Oldt, 5,624; Ms. Pugh, 2,706; Mr. Rosenberry, 2,706; Mr. Shoemaker, 28,198; Mr. Snoke, 2,706; Mr. Tuckey, 2,706; Mr. Ward, 2,706; Mr. Zullinger, 2,706; and all directors, nominees and executive officers as a group, 117,460 shares.

Section 16(a) Beneficial Ownership Reporting Compliance. Based on our records, we believe that during 2003 our directors and executive officers complied with all SEC filing requirements applicable to them.

ITEM 1 - ELECTION OF DIRECTORS

The By-laws of the Company provide that the directors will serve in three classes, as nearly equal in number as possible, with each class of directors

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

servings a staggered, three year term of office. At each annual meeting of shareholders, a class consisting of approximately one third of all of the Company's directors is elected to hold office for a term expiring at the annual meeting held in the third year following the year of their election and until their successors have been elected. At the Annual Meeting the shareholders will be asked to elect three directors to Class B to serve until the annual meeting of shareholders in 2007 or until their successor is elected.

The Board of Directors has nominated the following persons for election as directors to Class B:

Gregory A. Rosenberry
Glenn W. Snoke
Denver L. Tuckey

All of the nominees are presently serving as directors of the Company and of Orrstown Bank, the wholly owned bank subsidiary of the Company.

Your shares of Company Common Stock represented by your proxy will be voted FOR the election of the three named nominees unless you mark the proxy form to withhold authority to vote for one or more of the nominees. If one or more of the nominees is unable or unwilling to serve as a director, the persons named in the proxy will vote for the election of such substitute nominee, if any, as will be named by the Board of Directors. The Company has no reason to believe that any of the nominees will be unable or unwilling to serve as a director. Each nominee has expressed a willingness to serve if elected.

The Board of Directors recommends a vote FOR the election of all three nominees as directors to Class B.

Biographical Summaries of Nominees and Directors

Information about the nominees for election as directors to Class B at the Annual Meeting and information about the directors in Class A and Class C is set forth below.

CLASS A DIRECTORS - TERM EXPIRES 2005

Name	Age	Principal occupation for last 5 years and position with the Company	Director Since
Jeffrey W. Coy (2)	52	State Legislator; Vice Chairman of the Company and the Bank	1984(1)
John S. Ward (3)	66	President, Modern Transit Partnership, a non-profit organization created to support bringing commuter rail to Central Pennsylvania; retired Chief Clerk, Cumberland County, Pennsylvania	1999
Joel R. Zullinger (2)	55	Attorney-at-Law; Chairman of the Board of the Company and the	1981(1)

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

Bank

CLASS B DIRECTORS - TERM EXPIRES 2007

Name	Age	Principal Occupation for last 5 years and position with the Company	Director Since
Gregory A. Rosenberry	49	President, Tri-Valley Forestry, Inc., a timber harvesting and wholesale business	1997
Glenn W. Snoke	55	President, Snokes Excavating & Paving, Inc.	1999
Denver L. Tuckey (2) (3)	70	Retired businessman; Secretary of the Company and the Bank	1995

CLASS C DIRECTOR NOMINEES - TERM EXPIRES 2006

Name	Age	Principal occupation for last 5 years and position with the Company	Director Since
Anthony F. Ceddia (3)	60	President, Shippensburg University	1996
Andrea Pugh (3)	51	Owner, PharmCare Consultants, a pharmacy consulting business	1996
Kenneth R. Shoemaker (2)	56	President and Chief Executive Officer of the Company and the Bank	1986(1)

-
- (1) Includes service as director of Orrstown Bank during period prior to 1988, when Orrstown Bank became a wholly-owned subsidiary of the Company.
(2) Member of the Executive Committee of the Bank.

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

(3) Member of the Audit Committee.

Executive Officers

In addition to Kenneth R. Shoemaker, President and Chief Executive Officer of the Company and the Bank, who also serves on the Board of Directors and whose biographical information is set forth above, the Executive Officers of the Company and/or the Bank are:

Philip E. Fague - age 44; Executive Vice President and Assistant Treasurer of the Company; and Executive Vice President and Chief Sales and Service Officer of the Bank.

Stephen C. Oldt - age 61; Executive Vice President and Assistant Secretary of the Company; and Executive Vice President and Chief Operations Officer of the Bank.

Bradley S. Everly - age 52; Senior Vice President and Treasurer of the Company; and Senior Vice President and Chief Financial Officer of the Bank.

Barbara E. Brobst - age 45; Vice President and Senior Trust Officer of the Bank.

Stephen C. Caldwell - age 55; Vice President and Director of Human Resources of the Bank.

Nathan A. Eifert - age 35; Vice President and Director of Marketing of the Bank.

Jeffrey W. Embly - age 33; Vice President of the Company; and Vice President and Senior Loan Officer of the Bank.

Benjamin S. Stoops - age 52; Vice President and Chief Technology Officer of the Bank.

Board Committees and Meeting Attendance

During 2003 the Board of Directors of the Company met 13 times and the Board of Directors of Orrstown Bank met 13 times. The Board of Directors of the Company has an Executive Committee that did not hold any meetings in 2003, and an Audit Committee. The Board of Directors of the Bank has an Executive Committee. During 2003 all of the Directors of the Company and the Bank attended at least 75% of all meetings of the respective Boards and Committees on which they served. In addition, although the Company does not have a formal policy regarding the attendance by Directors at the Annual Meeting of Shareholders, it is generally expected that each Director will attend. All of the Company's Directors attended the Annual Meeting of Shareholders in 2003.

Executive Committee. The Executive Committee of the Bank's Board of Directors acts on matters between regular meetings of the Board of Directors. The Executive Committee also makes recommendations regarding compensation to the Board of Directors and reviews the qualifications of and makes recommendations to the Board of Directors regarding potential candidates to be nominated for election to the Board of Directors. Those candidates recommended by the Executive Committee are then submitted to the Board of Directors for approval as nominees. In making its recommendations, the Executive Committee determines the appropriate qualifications, skills and characteristics desirable for the Board of Directors in the context of the strategic direction of the Company and the Bank. Although there are no stated

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

minimum criteria for nominees, the Executive Committee considers a variety of factors including a candidate's integrity, independence, qualifications, skills, experience, including experience in finance and banking, compatibility with other members of the Board of Directors, and such other factors as it may deem to be in the best interest of the Bank, the Company and its shareholders, which factors may change from time to time. The Executive Committee will consider candidates recommended by shareholders, other directors and other sources including the community and the Bank's regional advisory boards. The Executive Committee met 13 times during 2003. The members of the Executive Committee are Jeffrey W. Coy, Chairman, Kenneth R. Shoemaker, Denver L. Tuckey and Joel R. Zullinger. The same individuals also constitute the Executive Committee of the Board of Directors of the Company. Although they hold offices of the Company and the Bank, the Board of Directors has determined that Messrs. Coy, Tuckey and Zullinger are independent as defined in the listing standards of the National Association of Securities Dealers, Inc. (NASD) because they hold such offices in their capacities as Directors and because they do not, except as Directors, perform a policy making function, and are not otherwise in charge of a principal business unit, division or function of the Company or the Bank. As President and Chief Executive Officer of the Company and the Bank, Mr. Shoemaker is not independent.

Audit Committee. The Audit Committee is responsible for providing independent oversight and review of the Company's accounting functions and financial reporting and internal control systems. The Audit Committee monitors the preparation of quarterly and annual financial reports by Company management, including reviewing with management and the Company's independent auditors the scope and results of the annual audit and recommendations made by the independent auditors and related management responses, and reviews prior to filing all annual and quarterly reports and proxy statements filed with the Securities and Exchange Commission (SEC). The Audit Committee also is responsible for matters concerning the relationship between the Company and its independent auditors including their appointment, compensation and retention; approval of their audit and permissible non-audit services prior to engagement; and determining whether the independent auditors are "independent." In addition, the Audit Committee oversees management's implementation and reviews the effectiveness of the Company's internal control systems including reviewing policies relating to legal and regulatory compliance, ethics and conflicts of interest; and reviewing the activities and recommendations of the Company's internal auditing program.

The Board of Directors revised the Audit Committee Charter in 2003 in order to bring it into conformity with requirements specified in the Sarbanes-Oxley Act of 2002 and related SEC regulations. A copy of the Audit Committee Charter, as revised, is included as Appendix A to this Proxy Statement.

The members of the Audit Committee are Andrea Pugh, Chair, Anthony F. Ceddia, Denver L. Tuckey and John S. Ward, each of whom the Board of Directors has determined to be independent as defined in NASD listing standards. The Audit Committee Charter provides that the Audit Committee shall consist of at least 3 directors, each of whom is to be "independent" as defined by applicable law and regulation, and who also is free of any relationship that, in the opinion of the Board, could interfere with the exercise of their independent judgment. Consequently, Glenn W. Snoke, who served on the Audit Committee through December, 2003, stepped down from service on the Audit Committee in order that the services his business, Snokes Excavating & Paving, Inc., performs from time to time on behalf of the Bank would not appear to compromise independence on his part or that of the Audit Committee as a whole.

The Audit Committee Charter also provides that at least one member of the Audit Committee must have accounting or related financial management expertise as the Board of Directors interprets such qualifications in its business

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

judgment. Although the Board of Directors believes that it is appropriate for the Audit Committee to have at least one member with accounting or related financial management expertise, it also believes that there are a number of other important factors, discussed above with respect to the factors considered by the Executive Committee in connection with candidates for nomination for election to the Board of Directors that affect Board composition. In accommodating each of these factors and composing a Board of Directors that is, as a whole, strong in its collective knowledge of and diversity of skills and experience with respect to the business of banking and the communities and markets in which the Bank competes, together with demonstrated qualities exhibiting leadership, vision and business judgment, it is possible that from time to time no member of the Board of Directors will fully satisfy all conditions of the definition of "audit committee financial expert" in SEC Regulation S-K.

The Board of Directors, however, believes that John S. Ward has the requisite financial management expertise required by the Audit Committee Charter as a result of his experience as Chief Clerk of Cumberland County, Pennsylvania, from which he is retired, and as President of Modern Transit Partnership. In each of these positions Mr. Ward was and is ultimately responsible for overseeing and assessing the performance of the County and the Partnership in the preparation of its respective financial statements, providing him with an understanding of and familiarity with generally accepted accounting principles and internal controls over financial reporting. The Board of Directors, however, has not determined that Mr. Ward is an "audit committee financial expert" as defined in SEC Regulation S-K principally because his experience has not presented to him the breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues raised by the Company's financial statements.

The Audit Committee Charter provides that the Audit Committee is to meet at least 4 times each year. The Audit Committee met 7 times during 2003.

Audit Committee Report

The Audit Committee has reviewed and discussed with management the Company's audited financial statements for the year ended December 31, 2003. The Audit Committee also has discussed with Smith Elliott Kearns & Company, LLC, the matters required to be discussed by Statement on Auditing Standards No. 61 (Communications with Audit Committees), received from Smith Elliott Kearns & Company, LLC, the written disclosures and letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with Smith Elliott Kearns & Company, LLC, that firm's independence. In that regard, the Audit Committee has considered whether the provision by Smith Elliott Kearns & Company, LLC, of certain limited permissible non-audit services in addition to its audit services is compatible with maintaining that firm's independence and has determined that

it is. Based on the review and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003 filed with the Securities and Exchange Commission.

Audit Committee:

Andrea Pugh, Chair
Anthony F. Ceddia
Denver L. Tuckey
John S. Ward

Compensation of Directors

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

Directors' Fees. During 2003, each director of the Company received \$600.00 for each meeting of the Company Board of Directors attended and \$250.00 for each committee meeting attended. Each director of Orrstown Bank was paid an annual retainer fee of \$7,500.00 and a fee of \$600.00 for each meeting attended. Non-employee directors of the Bank also receive \$250.00 for each committee meeting attended. In addition, in 2003 the Chairman of the Board of the Bank received an annual fee of \$10,500, the Vice Chairman received an annual fee of \$8,500 and the Secretary received an annual fee of \$7,500.

Deferred Compensation Plan. In 1995, the Company and Orrstown Bank established a non-qualified deferred compensation plan for directors. Participation in the plan is voluntary. Kenneth R. Shoemaker, President and Chief Executive Officer of the Company and the Bank, and Stephen C. Oldt, Executive Vice President and Chief Operating Officer of the Bank, also participate in the Plan. Each participant may elect each year to defer all or a portion of his or her directors' fees or, in the case of Messrs. Shoemaker and Oldt, base salary. Those deferring compensation must begin withdrawals from the plan by age 75. The amounts deferred are invested in a rabbi trust with the trust department of Orrstown Bank as trustee. The participants direct the investment of their own accounts and there is no guarantee as to investment performance. Growth of each participant's account is a result of investment performance and not as a result of an interest factor or interest formula established by the participant.

In addition, Orrstown Bank has a separate deferred compensation arrangement with seven of its directors or former members of its Board of Directors whereby a director or his or her beneficiaries will receive a monthly benefit beginning at age 65. The arrangement is funded by an amount of life insurance on each participating director calculated to meet the Bank's obligations under the compensation agreement. The cash value of future benefits to be paid, which are included in other liabilities on the Company's consolidated balance sheet, amounted to \$122,029 at December 31, 2003. Annual expense of \$12,325 was charged to operations for 2003.

Directors Retirement Plan. In 1998 Orrstown Bank established a director's retirement plan which provides participating directors a \$12,000 per year benefit (indexed for inflation by 4.00% per year until payments commence) for the lesser of ten years or the number of years served. This program encourages current directors to continue to serve as directors and enables the Bank to reward its long-serving directors for their valuable services.

Non-Employee Director Stock Option Plan of 2000. On January 27, 2000, the Board of Directors of the Company approved the Orrstown Financial Services, Inc. Non-Employee Director Stock Option Plan of 2000. The Directors' Option Plan is a formula plan under which options to purchase shares of Company Common Stock are granted each year to directors in office on April 1. The number of options granted each year is based on the Company's return on average equity for the most recent fiscal year. All options have a term of 10 years from the regular grant date, are fully exercisable from the regular grant date and have an exercise price equal to the "fair market value" of Company Common Stock as of the date of the grant of the option. As long as shares of Company Common Stock are traded over-the-counter and quotations for the shares appear on the NASD's OTC Bulletin Board service, "fair market value" will mean the average of the average of the daily high bid and low offer quotations for shares of Company Common Stock reported through the OTC Bulletin Board service for the 10 trading days immediately preceding the date of the grant of the option. If no bid or no offer quotations are available during the 10 day pricing period, then "fair market value" will mean the price of the last trade reported for the shares through the OTC Bulletin Board service. If a director "retires," whether as a result of reaching mandatory retirement age, or under any other circumstances

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

the Board of Directors, in its discretion, may determine to constitute retirement, the options previously granted to the director will expire at their scheduled expiration date. If a director's service as a director terminates for any other reason, the options previously granted to the director will expire six months after the date of termination of service unless scheduled to expire sooner. In April 2003, each director, except Mr. Shoemaker, was granted an option covering 566 shares of Company Common Stock at an exercise price of \$22.90 per share (both the number of shares and the exercise price have been restated to reflect the 2 for 1 stock split paid February 10, 2004).

Report on Executive Compensation

The Company does not have a compensation committee and no compensation was paid to executive officers of the Company by the Company in 2003. All compensation was paid by the Bank.

The Executive Committee of the Bank, composed of three non-employee Directors of the Bank and Kenneth R. Shoemaker, President and Chief Executive Officer of the Company and the Bank, conducts a full review each year of the Bank's executive compensation programs and is responsible for making recommendations to the full Board of Directors. Mr. Shoemaker does not participate in the Committee's evaluation of his performance for purposes of his compensation. With respect to other executive officers, the Committee considers the recommendations of Mr. Shoemaker before making final recommendations to the Board of Directors.

The Bank's executive compensation program has four main components:

Base Salary. The Executive Committee determines base salaries for executive officers based upon competitive pay practices of other banks of similar size on a regional basis for similar positions and responsibilities.

The Executive Committee obtains comparisons of base salaries paid by other banks from various sources, including L. R. Webber Associates, a Holidaysburg, Pennsylvania consulting firm. Annually, the Executive Committee recommends changes in base salaries of executive officers based on its evaluation of past performance, job duties, scope and responsibilities and expected future contributions. In determining the level of base salary, an individual's personal performance in achieving previously established goals is the most important factor.

Executive Incentive Plan. The Executive Committee also oversees the Bank's Executive Incentive Plan established in 1998. The purpose of the Plan is to support and promote the pursuit of the Bank's organizational objectives and financial goals through the payment of annual cash bonuses to executive officers and other key employees. Under the Plan, the percentage increase in earnings for the year is given a 75% weighting and the percentage increase in funds (deposits and short-term purchased funds) for the year is given a 25% weighting. The resulting percentage factors are then added together, resulting in a bonus percentage factor to be applied to an executive's salary to determine the amount of his or her bonus. For example, a 10% increase in earnings and a 20% increase in funds would result in a 12.5% bonus percentage factor ($10\% \times .75 = 7.5\%$, $20\% \times .25 = 5\%$; $7.5\% + 5\% = 12.5\%$). Assuming a base salary of \$100,000, the amount of the bonus would be \$12,500. Under the Plan, the Bank will pay out 50% of the bonus amount in the year to which the bonus relates, 25% in the next year and 25% in the second year. Thus, the amounts reported below in the Summary Compensation Table as paid in 2003 pursuant to the Executive Incentive Plan include 50% of the bonus amount earned in 2003, 25% of the bonus amount earned in 2002 and 25% of the bonus amount earned in 2001. The bonus amounts as to which payment is deferred to subsequent years are not vested and will be forfeited by an employee whose employment with the Bank is terminated prior to payment of the deferred amounts. In addition, in 2001, 2002 and 2003, the Board

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

of Directors determined, within its discretion under the Plan, to actually fund bonuses under the Plan at the rate of 50% of the bonus amount calculated pursuant to the principles described above. The Executive Committee and the Board of Directors have complete discretion as to whom bonuses will be awarded under the Plan and have the further discretion to award bonuses in excess of the amounts calculated pursuant to the Plan.

Stock Options. On January 27, 2000, the Board of Directors of the Company unanimously approved and adopted the Employee Stock Option Plan of 2000. The Stock Option Plan was ratified by the shareholders at the 2000 Annual Meeting. The purpose of the Stock Option Plan is to promote the long term success of the Company and the creation of shareholder value by providing additional incentives to those officers and key employees who are in a position to contribute to the long term growth and profitability of the Company; assist the Company to attract, retain and motivate key personnel with experience and ability; and link employees receiving stock options directly to shareholder interests through increased stock ownership.

The Executive Committee, on behalf of the Board of Directors, administers the Stock Option Plan, and determines the number of shares to be covered by each option, the term of the option, the period of time for options to vest after grant, if any, and other terms and limitations applicable to the exercise of the option. All options awarded under the Stock Option Plan are exercisable at an option price equal to the "fair market value" of the Company's common stock at the date of grant of the option. As long as shares of Company common stock are traded over the

counter and quotations for the shares appear on the NASD's OTC Bulletin Board service, "fair market value" shall mean the average of the daily high bid and low offer quotations for shares of Company common stock reported through the OTC Bulletin Board service for the 10 trading days immediately preceding the relevant date. If no bid or no offer quotations are available during the 10 day pricing period, then "fair market value" will mean the price of the last trade reported for the shares through the OTC Bulletin Board service. Grants to officers of the Company and other key employees are based on criteria established by the Executive Committee including, past performance, job duties, scope and responsibilities and contributions to overall Company performance.

Deferred Compensation and Supplemental Benefit Programs. The Bank has established certain deferred compensation and supplemental benefit programs described elsewhere in this proxy statement for certain of its executive officers. The purposes of these programs are to provide to those executive officers an economic incentive for long term service to the Company and the Bank. The Executive Committee believes that these programs are competitive with those offered by other banks of similar size on a regional basis.

Chief Executive Officer Compensation. Mr. Shoemaker's compensation for 2003 was established based upon the same factors and policies used to establish compensation for executive officers generally.

Executive Committee:

Jeffrey W. Coy, Chairman
Kenneth R. Shoemaker
Denver L. Tuckey
Joel R. Zullinger

Company Performance

The following graph shows a five-year comparison of the cumulative total return on Company Common Stock as compared to two other indexes: the S&P 500 Index and an index of banks with assets of under \$500 million in assets. For

Edgar Filing: ORRSTOWN FINANCIAL SERVICES INC - Form DEF 14A

2001, 2002 and 2003, shareholder returns on Company Common Stock are based upon trades reported by the National Association of Securities Dealers' Inc.'s OTC Bulletin Board service. For prior years, shareholder returns on Company Common Stock are based upon reports to the Company by shareholders that bought or sold shares during the indicated periods. The Company is not aware of all prices at which shares traded during such periods. The shareholder returns shown in the graph are not necessarily indicative of future performance.

Index	Period Ending					
	12/31/98	12/31/99	12/31/00	12/31/01	12/31/02	12/31/03
Orrstown Financial Services, Inc.	100.00	150.93	161.22	167.65	205.37	311.81
S&P 500	100.00	121.11	110.34	97.32	75.75	97.40
SNL						