QNB CORP
Form 10-K
March 13, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended **December 31, 2014**

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from _______________ to _______________ .

Commission file number **0-17706**

QNB Corp.
(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	**23-2318082**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
15 North Third Street, P.O. Box 9005 Quakertown, PA	**18951-9005**
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code **(215) 538-5600**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
None	**N/A**

Securities registered pursuant to Section 12(g) of the Act:
Title of each class
Common Stock, $0.625 par value

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act.

Yes ____ No ____

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ____ No ____

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ___ No____

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ___ No____

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ____ Accelerated filer ___ Non-accelerated filer ____ Smaller reporting company _

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ____ No ___

As of March 4, 2015, 3,322,985 shares of common stock of the registrant were outstanding. As of June 30, 2014, the aggregate market value of the common stock of the registrant held by non-affiliates was approximately $78,360,328 based upon the average bid and asked prices of the common stock as reported on the OTC BB.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of registrant's Proxy Statement for the annual meeting of its shareholders to be held May 26, 2015 are incorporated by reference in Part III of this report.

FORM 10-K INDEX

PART I

FORWARD-LOOKING STATEMENTS

In addition to historical information, this document contains forward-looking statements. Forward-looking statements are typically identified by words or phrases such as “believe,” “expect,” “anticipate,” “intend,” “estimate,” “project” and variat of such words and similar expressions, or future or conditional verbs such as “will,” “would,” “should,” “could,” “may” or similar expressions. The U.S. Private Securities Litigation Reform Act of 1995 provides a safe harbor in regard to the inclusion of forward-looking statements in this document and documents incorporated by reference.

Shareholders should note that many factors, some of which are discussed elsewhere in this document and in the documents that are incorporated by reference, could affect the future financial results of QNB Corp. and its subsidiary and could cause those results to differ materially from those expressed in the forward looking statements contained or incorporated by reference in this document. These factors include, but are not limited to, the following:

- Volatility in interest rates and shape of the yield curve;
- Credit risk;
- Liquidity risk;
- Operating, legal and regulatory risks;
- Economic, political and competitive forces affecting QNB Corp.’s business;
- The risk that the analysis of these risks and forces could be incorrect, and/or that the strategies developed to address them could be unsuccessful.

QNB Corp. (herein referred to as “QNB” or the “Company”) cautions that these forward-looking statements are subject to numerous assumptions, risks and uncertainties, all of which change over time, and QNB assumes no duty to update forward-looking statements. Management cautions readers not to place undue reliance on any forward-looking statements. These statements speak only as of the date of this Annual Report on Form 10-K, even if subsequently made available by QNB on its website or otherwise, and they advise readers that various factors, including those described above, could affect QNB’s financial performance and could cause actual results or circumstances for future periods to differ materially from those anticipated or projected. Except as required by law, QNB does not undertake, and specifically disclaims any obligation, to publicly release any revisions to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

ITEM 1. BUSINESS

Overview

QNB was incorporated under the laws of the Commonwealth of Pennsylvania on June 4, 1984. QNB is registered with the Board of Governors of the Federal Reserve System as a bank holding company under the Bank Holding Company Act of 1956 and conducts its business through its wholly-owned subsidiary, QNB Bank (the “Bank”).

Prior to December 28, 2007, the Bank was a national banking association organized in 1877 as The Quakertown National Bank, was chartered under the National Banking Act and was subject to Federal and state laws applicable to national banks. Effective December 28, 2007, the Bank became a Pennsylvania chartered commercial bank and changed its name to QNB Bank. The Bank, whose principal office is located in Quakertown, Bucks County, Pennsylvania operated eleven full-service community banking offices in Bucks, Montgomery and Lehigh counties in southeastern Pennsylvania as of December 31, 2014.

The Bank is engaged in the general commercial banking business and provides a full range of banking services to its customers. These banking services consist of, among other things, attracting deposits and using these funds in making commercial loans, residential mortgage loans, consumer loans, and purchasing investment securities. These deposits are in the form of time, demand and savings accounts. Time deposits include certificates of deposit and individual retirement accounts. The Bank’s demand and savings accounts include money market accounts, interest-bearing demand accounts (including a higher yielding checking account), club accounts, traditional statement savings accounts, and a higher yielding online savings account.

At December 31, 2014, QNB had total assets of $977,135,000, total loans of $555,282,000, total deposits of $851,592,000 and total shareholders’ equity of $86,354,000. For the year ended December 31, 2014, QNB reported net income of $8,998,000 compared to net income for the year ended December 31, 2013 of $8,392,000.

At February 27, 2015, the Bank had 169 full-time employees and 16 part-time employees. The Bank’s employees have a customer-oriented philosophy, a strong commitment to service and a “sincere interest” in their customers’ success. They maintain close contact with both the residents and local business people in the communities in which they serve, responding to changes in market conditions and customer requests in a timely manner.

Competition and Market Area

The banking business is highly competitive, and the profitability of QNB depends principally upon the Bank’s ability to compete in its market area. QNB faces intense competition within its market, both in making loans and attracting deposits. Bucks, Lehigh, and Montgomery counties have a high concentration of financial institutions, including large national and regional banks, community banks, savings institutions and credit unions. Some of QNB’s competitors offer products and services that QNB currently does not offer, such as traditional trust services and full-service insurance.

In addition, as a result of consolidation in the banking industry, some of QNB’s competitors may enjoy advantages such as greater financial resources, a wider geographic presence, more favorable pricing alternatives and lower origination and operating costs. However, QNB has been able to compete effectively with other financial institutions by emphasizing the establishment of long-term relationships and customer loyalty. A strong focus on small-business solutions, providing fast local decision-making on loans, exceptional personal customer service and technology solutions, including internet- and mobile-banking, electronic bill pay and remote deposit capture, also enable QNB to compete successfully.

Competition for loans and deposits comes principally from commercial banks, savings institutions, credit unions and non-bank financial service providers. Factors in successfully competing for deposits include providing excellent customer service, convenient locations and hours of operation, attractive rates, low fees, and alternative delivery systems. One such delivery system is remote deposit capture for those commercial customers that are not conveniently located near one of our branches, or mobile banking for retail customers. Successful loan origination tends to depend not only on interest rate and terms of the loan but on being responsive and flexible to the customers’ needs. While many competitors within the Bank’s primary market have substantially higher legal lending limits, QNB often has the ability, through loan participations, to meet the larger lending needs of its customers.

QNB’s success is dependent to a significant degree on economic conditions in southeastern Pennsylvania, especially Bucks, Lehigh and Montgomery counties, which it defines as its primary market. The banking industry is affected by general economic conditions, including the effects of recession, unemployment, declining real estate values, inflation, trends in the national and global economies, and other factors beyond QNB’s control.

Monetary Policy and Economic Conditions

The business of financial institutions is affected not only by general economic conditions, but also by the policies of various governmental regulatory agencies, including the Federal Reserve Board. The Federal Reserve Board regulates money, credit conditions and interest rates to influence general economic conditions primarily through open market operations in U.S. government securities, changes in the discount rate on bank borrowings and changes in the reserve requirements against depository institutions’ deposits. These policies and regulations significantly affect the overall growth and distribution of loans, investments and deposits, as well as the interest rates charged on loans and the interest rates paid on deposits.

The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of financial institutions in the past and are expected to continue to have significant effects in the future. In view of the changing conditions in the economy and the financial markets in addition to the activities of monetary and fiscal authorities, the prediction of future changes in interest rates, credit availability or deposit levels is very challenging.

Supervision and Regulation

Banks and bank holding companies operate in a highly regulated environment and are regularly examined by Federal and state regulatory authorities. Federal statutes that apply to QNB and its subsidiary include the Bank Holding Company Act of 1956 (“BHCA”), the Federal Reserve Act and the Federal Deposit Insurance Act (“FDIA”), as those statutes have been significantly amended by recent laws such as the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Gramm-Leach-Bliley Act (“GLBA”), and others. In general, these statutes regulate the corporate governance of the Bank and eligible business activities of QNB, and impose certain restrictions and limitations on such important matters as mergers and acquisitions, intercompany transactions, loans and dividends, and capital adequacy, among others. Other corporate governance requirements are imposed on QNB by Federal securities and other laws, including the Sarbanes-Oxley Act, described later.

The Company is under the jurisdiction of the Securities and Exchange Commission and of state securities commissions for matters relating to the offering and sale of its securities. In addition, the Company is subject to the Securities and Exchange Commission’s rules and regulations relating to periodic reporting, proxy solicitation and insider trading.

Set forth below is a brief summary of some of the significant regulatory concepts and recent laws that affect QNB and the Bank. To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by references to the particular statutory or regulatory provisions themselves. Proposals to change banking laws and regulations are frequently introduced in Congress, the state legislatures, and before the various bank regulatory agencies. QNB cannot determine the likelihood of passage or timing of any such proposals or legislation or the impact they may have on QNB and its subsidiary. A change in law, regulations or regulatory policy may have a material effect on QNB and its subsidiary.

Bank Holding Company Regulation

QNB is registered as a bank holding company and is subject to the regulations of the Board of Governors of the Federal Reserve System (the “Federal Reserve”) under the BHCA. In addition, QNB Corp., as a Pennsylvania business corporation, is subject to the provisions of Section 115 of the Pennsylvania Banking Code of 1965 and the Pennsylvania Business Corporation Law of 1988, as amended.

Bank holding companies are required to file periodic reports with, and are subject to examination by, the Federal Reserve. The Federal Reserve’s regulations require a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. As a result, the Federal Reserve, pursuant to its “source of strength” regulations, may require QNB to commit its resources to provide adequate capital funds to the Bank during periods of financial distress or adversity.

Federal Reserve approval may be required before QNB may begin to engage in any non-banking activity and before any non-banking business may be acquired by QNB.

Regulatory Restrictions on Dividends

Dividend payments made by the Bank to the Company are subject to the Pennsylvania Banking Code, the Federal Deposit Insurance Act, and the regulations of the FDIC. Under the Banking Code, no dividends may be paid except from “accumulated net earnings” (generally retained earnings). The Federal Reserve Board and the FDIC have formal and informal policies which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings, with some exceptions. Under the FDIA, the Bank is prohibited from paying any dividends, making other distributions or paying any management fees if, after such payment, it would fail to satisfy its minimum capital requirements. The Pennsylvania Banking Code restricts the availability of capital funds for payment of dividends by the Bank generally to its accumulated net earnings. See also “Supervision and Regulation – Bank Regulation”.

In addition to the dividend restrictions described above, the banking regulators have the authority to prohibit or to limit the payment of dividends by the Bank if, in the banking regulator’s opinion, payment of a dividend would constitute an unsafe or unsound practice in light of the financial condition of the Bank.

Under Pennsylvania law, QNB may not pay a dividend, if, after giving effect thereto, it would be unable to pay its debts as they become due in the usual course of business and, after giving effect to the dividend, the total assets of QNB would be less than the sum of its total liabilities plus the amount that would be needed, if QNB were to be dissolved at the time of distribution, to satisfy the preferential rights upon dissolution of shareholders whose rights are superior to those receiving the dividend.

It is also the policy of the Federal Reserve that a bank holding company generally only pay dividends on common stock out of net income available to common shareholders over the past year and only if the prospective rate of earnings retention appears consistent with a bank holding company's capital needs, asset quality, and overall financial condition. In the current financial and economic environment, the Federal Reserve has indicated that bank holding companies should carefully review their dividend policy and has discouraged dividend pay-out ratios at the 100% level unless both asset quality and capital are very strong. A bank holding company also should not maintain a dividend level that places undue pressure on the capital of such institution's subsidiaries, or that may undermine the bank holding company's ability to serve as a source of strength for such subsidiaries.

Under these policies and subject to the restrictions applicable to the Bank, to remain "well-capitalized," the Bank had approximately $20,770,000 available for payment of dividends to the Company at December 31, 2014.

Capital Adequacy

Bank holding companies are required to comply with the Federal Reserve's risk-based capital guidelines. The required minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. At least half of total capital must be Tier 1 capital. Tier 1 capital consists principally of common shareholders' equity, plus retained earnings, less certain intangible assets. The remainder of total capital may consist of the allowance for loan losses, which is considered Tier 2 capital. At December 31, 2014, QNB's Tier 1 capital and total capital (Tier 1 and Tier 2 combined) ratios were 12.79% and 14.06%, respectively.

In addition to the risk-based capital guidelines, the Federal Reserve requires a bank holding company to maintain a minimum leverage ratio. This requires a minimum level of Tier 1 capital (as determined under the risk-based capital rules) to average total consolidated assets of 4% for those bank holding companies that have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. The Federal Reserve expects all other bank holding companies to maintain a ratio of at least 1% to 2% above the stated minimum. At December 31, 2014, QNB's leverage ratio was 8.65%.

Pursuant to the prompt corrective action provisions of the FDIA, the Federal banking agencies have specified, by regulation, the levels at which an insured institution is considered well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized. Under these regulations, an institution is considered well capitalized if it satisfies each of the following requirements:

- Total risk-based capital ratio of 10% or more,
- Tier 1 risk-based capital ratio of 6% or more,
- Leverage ratio of 5% or more, and
- Not subject to any order or written directive to meet and maintain a specific capital level

At December 31, 2014, the Bank qualified as well capitalized under these regulatory standards. See Note 19 of the Notes to Consolidated Financial Statements included at Item 8 of this Report for additional information.

In July 2013, the federal bank regulatory agencies adopted revisions to the agencies' capital adequacy guidelines and prompt corrective action rules, which were designed to enhance such requirements and implement the revised standards of the Basel Committee on Banking Supervision, commonly referred to as Basel III. The final rules generally implement higher minimum capital requirements, add a new common equity Tier 1 capital requirement, and establish criteria that instruments must meet to be considered common equity Tier 1 capital, additional Tier 1 capital or Tier 2 capital. The new minimum capital to risk-adjusted assets requirements are a common equity Tier 1 capital ratio of 4.5% (6.5% to be considered "well capitalized") and a Tier 1 capital ratio of 6.0%, increased from 4.0% (and increased from 6.0% to 8.0% to be considered "well capitalized"); the total capital ratio remains at 8.0% under the new rules (10.0% to be considered "well capitalized"). Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity Tier 1 capital above its minimum risk-based capital requirements in an amount greater than 2.5% of total risk-weighted assets. The new minimum capital requirements are effective on January 1, 2015. The capital contribution buffer requirements phase in over a three-year period beginning January 1, 2016.

Bank Regulation

As a Pennsylvania chartered, insured commercial bank, the Bank is subject to extensive regulation and examination by the Pennsylvania Department of Banking and Securities (the Department) and by the FDIC, which insures its deposits to the maximum extent permitted by law.

The Federal and state laws and regulations applicable to banks regulate, among other things, the scope of their business, their investments, the reserves required to be kept against deposits, the timing of the availability of deposited funds, the nature and amount of collateral for certain loans, the activities of a bank with respect to mergers and consolidations, and the establishment of branches. The laws and regulations governing the Bank generally have been promulgated to protect depositors and not for the purpose of protecting QNB's shareholders. This regulatory structure also gives the Federal and state banking agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Department, the FDIC or the United States Congress, could have a material impact on the Company, the Bank and their operations.

As a subsidiary bank of a bank holding company, the Bank is subject to certain restrictions imposed by the Federal Reserve Act on extensions of credit to QNB, on investments in the stock or other securities of QNB, and on taking such stock or securities as collateral for loans.

FDIC Insurance Assessments

The Bank’s deposits are insured to the applicable limits as determined by the FDIC, which is currently $250,000 per depositor.

The FDIC has adopted a risk-based premium system that provides for quarterly assessments (billed in arrears) based on an insured institution’s ranking in one of four risk categories based on their examination ratings and capital ratios. Well-capitalized institutions with the CAMELS ratings of 1 or 2 are grouped in Risk Category I.

Beginning with the second quarter of 2011, as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), the assessment base that the FDIC uses to calculate assessment premiums is a bank’s average assets minus average tangible equity. As the asset base of the banking industry is larger than the deposit base, the range of assessment rates will be from a low of 2.5 basis points to a high of 45 basis points, per $100 of assets.

The FDIC is required under the Dodd-Frank Act to establish assessment rates that will allow the Deposit Insurance Fund to achieve a reserve ratio of 1.35% of Insurance Fund insured deposits by September 2020. In addition, the FDIC has established a “designated reserve ratio” of 2.0%, a target ratio that, until it is achieved, will not likely result in the FDIC reducing assessment rates. In attempting to achieve the mandated 1.35% ratio, the FDIC is required to implement assessment formulas that charge banks over $10 billion in asset size more than banks under that size. Those new formulas began in the second quarter of 2011, but did not affect the Bank. Under the Dodd-Frank Act, the FDIC is authorized to make reimbursements from the Insurance Fund to banks if the reserve ratio exceeds 1.50%, but the FDIC has adopted the “designated reserve ratio” of 2.0% and has announced that any reimbursements from the fund are indefinitely suspended. For the years ended December 31, 2014 and 2013, the Bank recorded $620,000 and $651,000, respectively, in FDIC deposit insurance premium expense.

In addition, all insured institutions of the FDIC are required to pay assessments to fund interest payments on Financing Corporation (FICO) bonds. The Financing Corporation was created by Congress to issue bonds to finance the resolution of failed thrift institutions. Prior to 1997, only thrift institutions were subject to assessments to raise funds to pay the FICO bonds; however, beginning in 2000, commercial banks and thrifts are subject to the same assessment for FICO bonds. The FDIC has the authority to set the Financing Corporation assessment rate every quarter. The expense for 2014 and 2013 recorded by QNB was $66,000 and $54,000, respectively. These assessments will continue until the Financing Corporation bonds mature from 2017 through 2019.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank of Pittsburgh (FHLB), which is one of 12 regional Federal Home Loan Banks. Each Federal Home Loan Bank serves as a reserve or central bank for members within its assigned region. It is funded primarily from funds deposited by member institutions and proceeds from the sale of consolidated obligations of the Federal Home Loan Bank System. It makes loans to members (i.e. advances) in accordance with policies and procedures established by the board of directors of the Federal Home Loan Bank. At December 31, 2014, the Bank had no overnight FHLB advances outstanding.

As a member, the Bank is required to purchase and maintain stock in the FHLB in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of its outstanding advances from the FHLB. At December 31, 2014, the Bank had $635,000 in stock of the FHLB.

Community Reinvestment Act

Under the Community Reinvestment Act (“CRA”), as amended, the FDIC is required to assess all financial institutions that it regulates to determine whether these institutions are meeting the credit needs of the communities that they serve. The act focuses specifically on low and moderate income neighborhoods.

An institution’s record is considered during the evaluation of any application made by such institutions for, among other things:

- Approval of a branch or other deposit facility;
- An office relocation or a merger; and
- Any acquisition of bank shares.

The CRA, as amended, also requires that the regulatory agency make publicly available the evaluation of the Bank’s record of meeting the credit needs of its entire community, including low and moderate income neighborhoods. This evaluation includes a descriptive rating of either outstanding, satisfactory, needs to improve, or substantial noncompliance, and a statement describing the basis for the rating. The Bank’s most recent CRA rating was “Satisfactory”.

USA Patriot Act

The USA Patriot Act strengthens the anti-money laundering provisions of the Bank Secrecy Act. The Act requires financial institutions to establish certain procedures to be able to identify and verify the identity of its customers. Specifically the Bank must have procedures in place to:

- Verify the identity of persons applying to open an account;
- Ensure adequate maintenance of the records used to verify a person's identity; and
- Determine whether a person is on any U.S. government agency list of known or suspected terrorists or a terrorist organization.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act is intended to bolster public confidence in the nation's capital markets by imposing new duties and penalties for non-compliance on public companies and their executives, directors, auditors, attorneys and securities analysts. Some of the more significant aspects of the Act include:

- Corporate Responsibility for Financial Reports - requires Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) to certify certain matters relating to a company's financial records and accounting and internal controls.
- Management Assessment of Internal Controls - requires auditors to certify the company's underlying controls and processes that are used to compile the financial results for companies that are accelerated filers.
- Real-time Issuer Disclosures - requires that companies provide real-time disclosures of any events that may affect its stock price or financial performance, generally within a 48-hour period.
- Criminal Penalties for Altering Documents - provides severe penalties for "whoever knowingly alters, destroys, mutilates" any record or document with intent to impede an investigation. Penalties include monetary fines and prison time.

The Act also imposes requirements for corporate governance, auditor independence, accounting standards, audit committee member independence and increased authority, executive compensation, insider loans and whistleblower protection. As a result of the Act, QNB adopted a Code of Business Conduct and Ethics applicable to its CEO, CFO and Controller, which meets the requirements of the Act, to supplement its long-standing Code of Ethics, which applies to all directors and employees.

QNB's Code of Business Conduct and Ethics can be found on the Bank's website at www.qnbbank.com.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act)

The Dodd-Frank Act was enacted on July 21, 2010. This law made significant changes to the bank regulatory structure and affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies.

The Dodd-Frank Act required various Federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. The Federal agencies were given significant discretion in drafting such rules and regulations, and are still modifying many of the provisions. Consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for some time.

Bank and thrift holding companies with assets of less than $15 billion as of December 31, 2009, such as the Company, will be permitted to include trust preferred securities that were issued before May 19, 2010, as Tier 1 capital; however, trust preferred securities issued by a bank or thrift holding company (other than those with assets of less than $500 million) after May 19, 2010, will no longer count as Tier 1 capital. Trust preferred securities still will be entitled to be treated as Tier 2 capital.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets such as the Bank will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakened the Federal preemption rules that had been applicable for national banks and Federal savings associations, and gave state attorneys general the ability to enforce Federal consumer protection laws.

As mandated by the Dodd-Frank Act, in December 2013, the OCC, FRB, FDIC, and SEC issued a final rule implementing certain prohibitions and restrictions on the ability of a banking entity and non-bank financial company supervised by the FRB to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund (the so-called "Volcker Rule"). The final rules also require regulated entities to establish an internal compliance program that is consistent with the extent to which it engages in activities covered by the Volcker Rule, which must include making regular reports about those activities to regulators. Although the final rules provide some compliance and reporting exceptions based on size, the fundamental prohibitions of the Volcker Rule apply to banking entities of any size, including the Company. The final rules were effective April 1, 2014, with an extended effective date of July 2015. Under the final rules implementing the Volcker Rule, financial institutions are prohibited from owning certain covered funds. The Company has reviewed its securities holdings and does not believe that any qualify as impermissible holdings. If future regulatory interpretation requires us to divest of any such investments, it could cause us to recognize unexpected losses on the dispositions.

Many of the provisions of Dodd-Frank do not apply to the Bank, as it does not engage in many of the specific activities sought to be regulated by Dodd-Frank. Many of the provisions, however, such as the increased capital requirements that begin in 2015 and the changes to FDIC insurance premiums already implemented, affect all banking entities. In addition, the financial crisis of 2008 and the enactment of the Dodd-Frank Act in response to that crisis has resulted in an era of increased regulatory oversight over all financial entities. The ultimate changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

Possible Future Legislation

Congress is often considering some financial industry legislation, and the Federal banking agencies routinely propose new regulations. The Company cannot predict the future effect any new legislation, or new rules adopted by Federal or state banking agencies will have on the business of the Company and its subsidiaries. Given that the financial industry remains under stress and severe scrutiny, and given that the U.S. economy has not yet fully recovered to pre-crisis levels of activity, the Company expects that there will be significant legislation and regulatory actions that may materially affect the banking industry for the foreseeable future.

Additional Information

QNB's principal executive offices are located at 320 West Broad Street, Quakertown, Pennsylvania. Its telephone number is (215) 538-5600. This annual report, including the exhibits and schedules filed as part of the annual report on Form 10-K, may be inspected at the public reference facility maintained by the Securities and Exchange Commission (SEC) at its public reference room at 100 F Street, NE, Washington, DC 20549 and copies of all, or any part thereof, may be obtained from that office upon payment of the prescribed fees. You may call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room, and you can request copies of the documents upon payment of a duplicating fee by writing to the SEC. In addition, the SEC maintains a website that contains reports, proxy and information statements and other information regarding registrants, including QNB, that file electronically with the SEC which can be accessed at www.sec.gov.

QNB also makes its periodic and current reports available, free of charge, on its website, www.qnbbank.com, as soon as reasonably practicable after such material is electronically filed with the SEC. Information available on the website is not a part of, and should not be incorporated into, this annual report on Form 10-K.

ITEM 1A. RISK FACTORS

The following discusses risks that management believes are specific to our business and could have a negative impact on QNB's financial performance. When analyzing an investment in QNB, the risks and uncertainties described below, together with all of the other information included or incorporated by reference in this report, should be carefully considered. This list should not be viewed as comprehensive and may not include all risks that may affect the financial performance of QNB.

1) Unfavorable economic and financial market conditions may adversely affect our financial condition and results of operations.

Over the past several years, concerns over the stability of the financial markets and the economy have resulted in decreased lending by some financial institutions to their customers and to each other. This market turmoil and tightening of credit led to increased commercial and consumer deficiencies, lack of customer confidence, increased market volatility and widespread reduction in general business activity. The resulting economic pressure on consumers and businesses and the lack of confidence in the financial markets may adversely affect our business, financial condition, results of operations and stock price. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the industry. In particular, we may face the following risks in connection with these events:

- We expect to face increased regulation of our industry. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities.
- Our ability to assess the creditworthiness of customers and to estimate the losses inherent in our credit exposure is made more complex by these difficult market and economic conditions.
- We also may be required to pay higher FDIC premiums because further financial institution failures could reduce the deposit insurance fund and its ratio of reserves to insured deposits to a level where higher premiums would be necessary.
- Our ability to borrow from other financial institutions or the FHLB could be adversely affected by disruptions in the capital markets or other events.
- We may experience increases in foreclosures, delinquencies and customer bankruptcies.

2) Our net interest income, net income and results of operations are sensitive to fluctuations in interest rates.

QNB's profitability is largely a function of the spread between the interest rates earned on earning assets and the interest rates paid on deposits and other interest-bearing liabilities. Like most financial institutions, QNB's net interest income and margin will be affected by general economic conditions and other factors, including fiscal and monetary policies of the Federal government, that influence market interest rates and QNB's ability to respond to changes in such rates. At any given time, QNB's assets and liabilities may be such that they are affected differently by a change in interest rates. As a result, an increase or decrease in rates, the length of loan terms or the mix of adjustable- and fixed-rate loans or investment securities in QNB's portfolio could have a positive or negative effect on its net income, capital and liquidity. Although management believes it has implemented strategies and guidelines to reduce the potential effects of adverse changes in interest rates on results of operations, any substantial and prolonged change in market interest rates could affect operating results negatively.

The yield curve for the various maturities of U.S. Treasury securities provides a fundamental barometer that gauges the prevailing interest rate profile and, simultaneously, acts as a guidepost for current loan and deposit pricing constraints. The slope of the yield curve is driven primarily by expectations for future interest rate increases and inflationary trends. A normal yield curve has a slope that reflects lower costs for shorter-term financial instruments, accompanied by increases in costs for longer term instruments all along the maturity continuum.

Short-term interest rates are highly influenced by the monetary policy of the Federal Reserve. The Federal Open Market Committee, a committee of the Federal Reserve, targets the Federal funds rate, the overnight rate at which banks borrow or lend excess funds between financial institutions. This rate serves as a benchmark for the overnight money costs, and correspondingly influences the pricing of a significant portion of a bank's deposit funding sources. Intermediate and longer-term interest rates, unlike the Federal funds rate, are more directly influenced by external market forces, including perceptions about future interest rates and inflation. These trends, in turn, influence the pricing on mid- and long-term loan commitments as well as deposits and bank borrowings that have scheduled maturities.

Generally speaking, a yield curve with a higher degree of slope provides more opportunity to increase the spread between earning asset yields and funding costs. It should be emphasized that while the yield curve is a critical benchmark in setting prices for various monetary assets and liabilities in banks, its influence is not exerted in a vacuum. Credit risk, market risk, competitive issues, and other factors must all be considered in the pricing of financial instruments. A steep or highly-sloped yield curve may be a precursor of higher interest rates or elevated inflation in the future, while a flat yield curve may be characteristic of a Federal Reserve policy designed to calm an overheated economy by tightening credit availability via increases in short-term rates. If other rates along the maturity spectrum do not rise correspondingly, the yield curve can be expected to flatten. This scenario may reflect an economic outlook that has little or no expectation of higher future interest rates or higher rates of inflation. For banks, the presence of a flat yield curve for a prolonged or sustained period could measurably lower expectations for expanding the net interest margin.

An inverted yield curve is the opposite of a normal yield curve and is characterized by short-term rates that are higher than longer-term rates. The presence of an inverted yield curve is considered to be an anomaly that is almost counterintuitive to the core business of banking. Inverted yield curves do not typically exist for more than a short period of time. In past economic cycles, the presence of an inverted yield curve has frequently foreshadowed a recession. The slow economic recovery that lasted many years may suppress future asset growth trends and/or increase the influence of other forms of risk, such as credit risk, which could hamper opportunities for revenue expansion and earnings growth in the near term.

3) We are subject to credit risk in connection with our lending activities, and our financial condition and results of operations may be negatively affected by economic conditions and other factors that could adversely affect our customers.

As a lender, QNB is exposed to the risk that its borrowers may be unable to repay their loans and that the current market value of any collateral securing the payment of their loans may not be sufficient to assure repayment in full. Credit losses are inherent in the lending business and could have a material adverse effect on the operating results of QNB. Adverse changes in the economy or business conditions, either nationally or in QNB's market areas, could increase credit-related losses and expenses and/or limit growth. Substantially all of QNB's loans are to businesses and individuals in its limited geographic area and any economic decline in this market could impact QNB adversely. QNB makes various assumptions and judgments about the collectability of its loan portfolio and provides an allowance for loan losses based on a number of factors. If these assumptions are incorrect, the allowance for loan losses may not be sufficient to cover losses and may cause QNB to increase the allowance in the future by increasing the provision for loan losses, thereby having an adverse effect on operating results. QNB has adopted underwriting and credit monitoring procedures and credit policies that management believes are appropriate to control these risks; however, such policies and procedures may not prevent unexpected losses that could have a material adverse effect on QNB's financial condition or results of operations.

4) We face significant competition from other banks and financial institutions in our market area, many of which are larger in terms of asset size and market capitalization.

The financial services industry is highly competitive with competition for attracting and retaining deposits and making loans coming from other banks and savings institutions, credit unions, mutual fund companies, insurance companies and other non-bank businesses. Many of QNB's competitors are much larger in terms of total assets and market capitalization, have a higher lending limit, have greater access to capital and funding, and offer a broader array of financial products and services. In light of this, QNB's ability to continue to compete effectively is dependent upon its ability to maintain and build relationships by delivering top quality service.

At December 31, 2014, our lending limit per borrower was approximately $13,033,000. Accordingly, the size of loans that we may offer to potential borrowers (without participation by other lenders) is less than the size of loans that many of our competitors with larger capitalization are able to offer. Our legal lending limit also impacts the efficiency of our lending operation because it tends to lower our average loan size, which means we have to generate a higher number of transactions to achieve the same portfolio volume. We may engage in loan participations with other banks for loans in excess of our legal lending limit. However, there can be no assurance that such participations will be available or on terms which are favorable to us and our customers.

5) Our results of operations may be adversely affected by other-than-temporary impairment charges relating to our investment portfolio.

QNB purchases U.S. Government and U.S. Government agency debt securities, U.S. Government agency issued mortgage-backed securities or collateralized mortgage obligation securities, obligations of states and municipalities, corporate debt securities and equity securities. QNB is exposed to the risk that the issuers of these securities may experience significant deterioration in credit quality which could impact the market value of the issue. QNB periodically evaluates its investments to determine if market value declines are other-than-temporary. Once a decline is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized for the credit related portion of the impairment.

The Bank holds six pooled trust preferred securities with an amortized cost of $3,519,000 and a fair value as of December 31, 2014 of $2,439,000. All of the trust preferred securities are available-for-sale securities and are carried at fair value. On January 14, 2014, Banking Regulators released a final interim rule authorizing retention of pooled trust preferred securities backed primarily by bank-issued trust preferred securities which included the PreTSLs held by QNB. While there was a noticeable increase in trading activity of these instruments in 2014, we believe most of these trades occurred under distress and do not represent trades made in an orderly market. Despite the trades that took place as discussed previously, the market for these securities at December 31, 2014 was not active and markets for similar securities also are not active. The new issue market is also inactive and the market values for these securities are depressed relative to historical levels. Lack of liquidity in the market for trust preferred collateralized debt obligations, credit rating downgrades and market uncertainties related to the financial industry are all factors contributing to the temporary impairment of these securities. Although these securities are classified as available-for-sale, the Company has the intent to hold the securities and does not believe it will be required to sell the securities before recovery occurs. These securities are comprised mainly of securities issued by banks, and to a lesser degree, insurance companies. QNB owns the mezzanine tranches of these securities, except for PreTSL IV which represents the senior-most obligation of the trust.

On a quarterly basis, we evaluate our debt securities for other-than-temporary impairment (“OTTI”), which involves the use of a third-party valuation firm to assist management with the valuation. When evaluating these investments a credit related portion and a non-credit related portion of OTTI are determined. All of the pooled trust preferred collateralized debt obligations held by QNB are rated lower than AA and are measured for OTTI within the scope of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 325 (formerly known as EITF 99-20-1). QNB performs a discounted cash flow analysis on all of its impaired debt securities to determine if the amortized cost basis of an impaired security will be recovered. In determining whether a credit loss exists, QNB uses its best estimate of the present value of cash flows expected to be collected from the debt security and discounts them at the effective yield implicit in the security at the date of acquisition or the prospective yield for those securities with prior OTTI charges. The discounted cash flow analysis is considered to be the primary evidence when determining whether credit related other-than-temporary impairment exists. The credit related portion is recognized in earnings and represents the expected shortfall in future cash flows. The non-credit related portion is recognized in other comprehensive income and represents the difference between the book value and the fair value of the security less any current quarter credit related impairment. During 2014 and 2013, there were no charges representing the recognition of credit impairments on our investment in pooled trust preferred collateralized debt obligations.

The Company's investment in marketable equity securities primarily consists of investments in large cap stock companies. These equity securities are analyzed for impairment on an ongoing basis. As a result of declines in some equity values, $43,000 of other-than-temporary impairment charges were taken in 2013. There was no OTTI in the equity securities portfolio in 2014. QNB had seven equity securities with unrealized losses of $70,000 at December 31, 2014. The severity and duration of the impairment is consistent with current stock market developments. Management believes these equity securities in an unrealized loss position will recover in the foreseeable future. QNB evaluated the near-term prospects of the issuers in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold those securities for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these equity securities to be other-than-temporarily impaired.

The Bank is a member of the FHLB and is required to purchase and maintain stock in the FHLB in an amount equal to the greater of 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year or 5% of its outstanding advances from the FHLB. At December 31, 2014, the Bank had $635,000 in stock of the FHLB which was in compliance with this requirement. These equity securities are restricted in that they can only be sold back to the respective institutions or another member institution at par. Therefore, they are less liquid than other tradable equity securities, their fair value is equal to amortized cost, and no impairment write-downs have been recorded on these securities.

6) Our assets at December 31, 2014 included a deferred tax asset and we may not be able to realize the full benefit of that asset.

As of December 31, 2014, QNB had a net deferred tax asset of $2,925,000. Our ability to realize these tax benefits ultimately depends on the existence of sufficient taxable income of the appropriate character (ordinary income or capital gains) within the applicable carryback and carryforward periods provided under the tax law. Estimating whether the deferred tax asset will be realized requires us to exercise significant judgment and is inherently uncertain because it requires the prediction of future occurrences. The deferred tax asset may be reduced in the future if estimates of future income or our tax planning strategies do not support the amount of the deferred tax asset. If it is determined in the future that a valuation allowance of the deferred tax asset is necessary, we may incur a charge to earnings resulting and a reduction to regulatory capital for the amount included in any such allowance.

7) A disruption in components of our business infrastructure resulting from financial or technological difficulties of our third party vendors on which we rely could adversely affect our business.

Third parties provide key components of the business infrastructure such as Internet connections and software platforms and network access. Any disruption in Internet, network access or other voice or data communication services provided by these third parties or any failure of these third parties to handle current or higher volumes of use could adversely affect the ability to deliver products and services to clients and otherwise to conduct business. Technological or financial difficulties of a third-party service provider could adversely affect the business to the extent those difficulties result in the interruption or discontinuation of services provided by that party.

8) Our failure to properly or timely utilize effective technologies to deliver our products and services, or a systems failure or breach of network security with respect to our information systems could adversely affect our business.

The market for financial services is increasingly affected by advances in technology, including developments in telecommunications, data processing, computers, automation, Internet-based banking and mobile banking. Our ability to compete successfully in our markets may depend on the extent to which we are able to exploit such technological changes. However, we can provide no assurance that we will be able to properly or timely anticipate or implement such technologies or properly train our staff to use such technologies. Any failure to adapt to new technologies could adversely affect our business, financial condition or operating results.

In addition, we rely heavily on our information systems to conduct business. Maintaining and protecting those systems is difficult and expensive, as is dealing with any failure, interruption or breach in security of these systems, whether due to acts or omissions by us or by a third party and whether intentional or not. Any such failure, interruption or breach could result in failures or disruptions in our customer relationship management or our information systems. The policies, procedures and technical safeguards we have in place to prevent or limit the effect of any failure, interruption or security breach of our information systems may be insufficient to prevent or remedy the effects of any such event. The occurrence of any failures, interruptions or security breaches of our information systems could damage our reputation, cause us to incur additional expenses, result in losses, or subject us to regulatory sanctions or additional regulatory scrutiny, any of which could adversely affect our business, financial condition or operating results.

9) Changes in accounting standards applicable to us could materially impact how we report our financial condition and results of operations.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. From time to time the FASB changes the financial accounting and reporting standards that govern the preparation of our financial statements.

These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements. Management believes the current financial statements are prepared in accordance with U.S. generally accepted accounting principles.

10) We are subject to numerous government regulations and to examination and supervision by bank regulatory agencies, which could have an adverse impact on our business and operations.

The banking industry is heavily regulated under both Federal and state law. Banking regulations, designed primarily for the safety of depositors, may limit a financial institution’s growth and the return to its investors, by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, expansion of branch offices and the offering of securities. QNB is also subject to capitalization guidelines established by Federal law and could be subject to enforcement actions to the extent that its subsidiary bank is found, by regulatory examiners, to be undercapitalized. It is difficult to predict what additional changes, if any, will be made to existing Federal and state legislation and regulations or the effect that such changes may have on QNB's future business and earnings prospects.

In response to the financial crisis that commenced in 2008, Congress has taken actions that are intended to strengthen confidence and encourage liquidity in financial institutions, and the FDIC has taken actions to increase insurance coverage on deposit accounts. The Dodd-Frank Act provides for the creation of a consumer protection division at the Board of Governors of the Federal Reserve System that will have broad authority to issue regulations governing the services and products we provide consumers. This additional regulation could increase our compliance costs and otherwise adversely impact our operations. That legislation also contains provisions that resulted in higher regulatory capital requirements and, over time, could result in higher loan loss provisions for the Bank, and may increase interest expense due to the ability, beginning in July 2011, to pay interest on all demand deposits.

The potential exists for additional Federal or state laws and regulations, or changes in policy, affecting many aspects of our operations, including capital levels, lending and funding practices, and liquidity standards. New laws and regulations may increase our costs of regulatory compliance and of doing business and otherwise affect our operations, and may significantly affect the markets in which we do business, the markets for and value of our loans and investments, the fees we can charge and our ongoing operations, costs and profitability.

11) We are required to pay FDIC insurance premiums, which could be increased in the future.

Since 2008, higher levels of bank failures have dramatically increased the claims against the deposit insurance fund. In addition, the Dodd-Frank Act permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor. These factors have placed additional stress on the deposit insurance fund. In order to maintain a strong funding position and restore reserve ratios of the deposit insurance fund, the FDIC has increased assessment rates of insured institutions, particularly those over $10 billion. The Company is generally unable to control the amount of premiums that the Bank is required to pay for FDIC insurance. If there are additional bank failures, or the cost of resolving prior failures exceeds expectations, the Bank may be required to pay even higher FDIC premiums than the recently increased levels. These announced increases and any future increases or required prepayments of FDIC insurance premiums may adversely impact the Company’s earnings and financial condition.

12) Our disclosure controls and procedures and our internal control over financial reporting may not achieve their intended objectives.

Management diligently reviews and updates its internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Our disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by QNB in reports filed or submitted under the Exchange Act is accumulated and communicated to management, and recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. Management believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Any undetected circumvention of these controls could have a material adverse impact on QNB’s financial condition and results of operations.

These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by an unauthorized override of the controls. Accordingly, because of the inherent limitations in our control system, misstatements due to error or fraud may occur and not be detected.

13) We may not be able to attract and retain highly qualified personnel to execute our business strategy.

Our success depends upon the ability to attract and retain highly motivated, well-qualified personnel. We face significant competition in the recruitment of qualified employees. Our ability to execute our business strategy and provide high quality service may suffer if we are unable to recruit or retain a sufficient number of qualified employees or if the costs of employee compensation or benefits increase substantially. QNB currently has employment agreements and change of control agreements with five of its senior officers.

14) Acts of terrorism and other external events could impact our ability to conduct business.

Financial institutions have been, and continue to be, targets of terrorist threats aimed at compromising operating and communication systems. Such events could cause significant damage, impact the stability of our facilities and result in additional expenses, impair the ability of our borrowers to repay their loans, and result in the loss of revenue. While we have established and regularly test disaster recovery procedures, the occurrence of any such event could have a material adverse effect on our business, operations and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

QNB Bank and QNB Corp.'s principal office is located at 15 North Third Street, Quakertown, Pennsylvania. QNB Bank conducts business from its principal office and ten other retail offices located in Bucks, Lehigh, and Montgomery counties in Pennsylvania. QNB Bank owns its principal office, three retail locations, its operations facility and a computer facility. QNB Bank leases its remaining seven retail properties. The leases on the properties generally contain renewal options. In management's opinion, these properties are in good condition and are currently adequate for QNB's purposes.

The following table details QNB Bank's properties:

Location	
• Quakertown, PA - Downtown Office - 15 North Third Street	Owned
• Quakertown, PA - Towne Bank Center - 320-322 West Broad Street	Owned
• Quakertown, PA - Computer Center - 121 West Broad Street	Owned
• Quakertown, PA - Country Square Office - 240 South West End Boulevard	Leased
• Quakertown, PA - Quakertown Commons Branch - 901 South West End Boulevard	Leased
• Dublin, PA - Dublin Branch - 161 North Main Street	Leased
• Pennsburg, PA - Pennsburg Square Branch - 410-420 Pottstown Avenue	Leased
• Coopersburg, PA - Coopersburg Branch - 51 South Third Street	Owned
• Perkasie, PA - Perkasie Branch - 607 Chestnut Street	Owned

• Souderton, PA - Souderton Branch - 750 Route 113	Leased
• Wescosville, PA - Wescosville Branch - 950 Mill Creek Road	Leased
• Colmar, PA - Colmar Branch - 127 Bethlehem Pike	Owned
• Warminster, PA – Warminster Business Office – 1410 West Street Road	Leased

ITEM 3. LEGAL PROCEEDINGS

Although there are currently no material proceedings to which QNB is the subject, future litigation that arises during the normal course of QNB's business could be material and have a negative impact on QNB's earnings. Future litigation also could adversely impact the reputation of QNB in the communities that it serves.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Stock Information

QNB common stock is quoted on the over-the-counter bulletin board (OTCBB). QNB had approximately 664 shareholders of record as of March 4, 2015.

The following table sets forth the high and low bid and ask stock prices for QNB common stock on a quarterly basis during 2014 and 2013. These prices reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

	High Bid	High Ask	Low Bid	Low Ask	Cash dividend per share
2014					
First Quarter	$26.01	$27.00	$25.15	$25.35	$ 0.28
Second Quarter	26.30	26.68	25.91	26.06	0.28
Third Quarter	27.00	28.44	26.09	26.50	0.28
Fourth Quarter	28.40	30.00	26.71	27.00	0.28
2013					
First Quarter	$25.00	$26.00	$23.00	$23.40	$ 0.27
Second Quarter	24.85	25.20	24.05	24.10	0.27
Third Quarter	25.20	25.50	24.10	24.13	0.27
Fourth Quarter	25.40	26.75	24.15	24.25	0.27

QNB has traditionally paid quarterly cash dividends on the last Friday of each quarter. The Company expects to continue the practice of paying quarterly cash dividends to its shareholders; however, future dividends are dependent upon future earnings, financial condition, appropriate legal restrictions, and other factors relevant at the time the board of directors considers declaring a dividend. Certain laws restrict the amount of dividends that may be paid to shareholders in any given year. See "Shareholders' Equity - Capital Adequacy" included in Item 7 of this Form 10-K filing, and Note 19 of the Notes to Consolidated Financial Statements included in Item 8 of this Form 10-K filing, for additional information that discusses and quantifies this regulatory restriction.

The following table provides information on repurchases by QNB of its common stock in each month of the quarter ended December 31, 2014.

Period	Average price	Maximum

	Total number of shares purchased	paid per share	Total number of shares purchased as part of publicly announced plan	number of shares that may yet to be purchased under the plan
October 1, 2014 through October 31, 2014	-	N/A	-	42,117
November 1, 2014 through November 30, 2014	-	N/A	-	42,117
December 1, 2014 through December 31, 2014	-	N/A	-	42,117

(1) Transactions are reported as of settlement dates.

(2) QNB's current stock repurchase plan was approved by its Board of Directors and announced on January 24, 2008 and subsequently increased on February 9, 2009.

(3) The total number of shares approved for repurchase under QNB's current stock repurchase plan is 100,000 as of the filing of this Form 10-K.

(4) QNB's current stock repurchase plan has no expiration date.

(5) QNB has no stock repurchase plan that it has determined to terminate or under which it does not intend to make further purchases.

Stock Performance Graph

Set forth below is a performance graph comparing the yearly cumulative total shareholder return on QNB's common stock with:

- the yearly cumulative total shareholder return on stocks included in the NASDAQ Market Index, a broad market index;
- the yearly cumulative total shareholder return on the SNL $500M to $1B Bank Index, a group encompassing publicly traded banking companies trading on the NYSE, AMEX, or NASDAQ with assets between $500 million and $1 billion;
- the yearly cumulative total shareholder return on the SNL Mid-Atlantic Bank Index, a group encompassing publicly traded banking companies trading on the NYSE, AMEX, or NASDAQ headquartered in Delaware, District of Columbia, Maryland, New Jersey, New York, Pennsylvania, and Puerto Rico.

All of these cumulative total returns are computed assuming the reinvestment of dividends at the frequency with which dividends were paid during the applicable years.

QNB Corp.

ITEM 6. SELECTED FINANCIAL DATA (in thousands, except share and per share data)

Year ended December 31,	**2014**	**2013**	**2012**	**2011**	**2010**
Income and expense					
Interest income	$30,670	$30,584	$33,348	$36,217	$36,183
Interest expense	4,544	5,033	6,448	8,091	10,270
Net interest income	26,126	25,551	26,900	28,126	25,913
Provision for loan losses	400	400	900	2,700	3,800
Non-interest income	7,542	5,813	5,409	4,226	4,339
Non-interest expense	21,626	20,226	19,625	18,296	17,401
Income before income taxes	11,642	10,738	11,784	11,356	9,051
Provision for income taxes	2,644	2,346	2,609	2,476	1,834
Net income	$8,998	$8,392	$9,175	$8,880	$7,217
Share and Per Share Data					
Net income - basic	$2.73	$2.58	$2.87	$2.82	$2.32
Net income - diluted	2.72	2.57	2.86	2.81	2.32
Book value	26.04	23.12	24.05	22.32	19.52
Cash dividends	1.12	1.08	1.04	1.00	0.96
Average common shares outstanding - basic	3,291,939	3,248,397	3,197,204	3,149,752	3,105,565
Average common shares outstanding - diluted	3,302,574	3,260,075	3,209,857	3,163,748	3,114,722
Balance Sheet at Year-end					
Investment securities trading	$4,207	-	-	-	-
Investment securities available-for-sale	375,219	$388,670	$401,502	$348,091	$290,564
Investment securities held-to-maturity	146	146	146	1,327	2,667
Restricted investment in bank stocks	647	1,764	2,244	1,775	2,176
Loans held-for-sale	380	-	1,616	935	228
Loans receivable	555,282	501,716	477,733	489,936	482,182
Allowance for loan losses	(8,001)	(8,925)	(9,772)	(9,241)	(8,955)
Other earning assets	7,143	3,569	594	819	6,414
Total assets	977,135	932,883	919,874	868,804	809,260
Deposits	851,592	814,532	801,638	750,712	694,977
Borrowed funds	35,189	40,156	37,775	44,320	50,094
Shareholders' equity	86,354	75,625	77,623	70,841	61,090
Selected Financial Ratios					
Net interest margin	3.07 %	3.09 %	3.36 %	3.72 %	3.72 %
Net income as a percentage of:					
Average total assets	0.95	0.91	1.03	1.06	0.93
Average shareholders' equity	10.89	10.95	13.07	13.99	12.53
Average shareholders' equity to average total assets	8.72	8.30	7.86	7.55	7.42
Dividend payout ratio	40.99	41.81	36.25	35.48	41.32

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations – Overview

QNB Corp. ("QNB" or the "Company") earns its net income primarily through its subsidiary, QNB Bank (the "Bank"). Net interest income, or the spread between the interest, dividends and fees earned on loans and investment securities and the expense incurred on deposits and other interest-bearing liabilities, is the primary source of operating income for QNB. QNB seeks to achieve sustainable and consistent earnings growth while maintaining adequate levels of capital and liquidity and limiting its exposure to credit and interest rate risk levels approved by the Board of Directors. Due to its limited geographic area, comprised principally of Bucks, Lehigh and Montgomery counties, growth is pursued through expansion of existing customer relationships and building new relationships by stressing a consistent high level of service at all points of contact.

Tabular information presented throughout management's discussion and analysis, other than share and per share data, is presented in thousands of dollars.

Net income for the year ended December 31, 2014 was $8,998,000, or $2.72 per share on a diluted basis. This compares to 2013 net income of $8,392,000, or $2.57 per share on a diluted basis. Two important measures of profitability in the banking industry are an institution's return on average assets and return on average shareholders' equity. Return on average assets was 0.95% and 0.91% in 2014 and 2013, respectively, and return on average shareholders' equity was 10.89% and 10.95%, respectively, during those same periods.

2014 versus 2013

The results for 2014 include the following significant components:

- Net interest income increased $575,000, or 2.3%, to $26,126,000 for 2014.
- The net interest margin on a tax-equivalent basis decreased two basis points to 3.07% for 2014 from 3.09% for 2013.
- QNB recorded a provision for loan losses of $400,000 for both 2014 and 2013.
- Non-interest income for 2014 was $7,542,000, an increase of $1,729,000, or 29.7%, compared to 2013. Non-interest expense for 2014 was $21,626,000, an increase of $1,400,000, or 6.9%, compared to 2013.
- Loans receivable grew $53,566,000, or 10.7%, from December 31, 2013. Deposits increased $37,060,000, or 4.5%, from December 31, 2013.
- Asset quality has improved over the past year. Total non-performing loans, which represent loans on non-accrual status, loans past due 90 days or more and still accruing interest, and restructured loans, were $12,667,000, or 2.28% of total loans at December 31, 2014, compared to $15,413,000, or 3.07% of total loans at December 31, 2013. Loans on non-accrual status were $10,770,000 at December 31, 2014 compared with $13,453,000 at December 31, 2013. Net charge-offs for 2014 were $1,324,000, or 0.25% of average total loans, as compared with $1,247,000, or 0.26% of average total loans for 2013.

These items, as well as others, will be explained more thoroughly in the next sections.

Net Interest Income

The following table presents the adjustment to convert net interest income to net interest income on a fully taxable equivalent basis for the years ended December 31, 2014 and 2013.

Year ended December 31,	**2014**	**2013**
Total interest income	$30,670	$30,584
Total interest expense	4,544	5,033
Net interest income	26,126	25,551
Tax equivalent adjustment	1,903	1,963
Net interest income (tax-equivalent basis)	$28,029	$27,514

Net interest income is the primary source of operating income for QNB. Net interest income is interest income, dividends, and fees on earning assets, less interest expense incurred for funding sources. Earning assets primarily include loans, investment securities and interest bearing balances at the Federal Reserve Bank (Fed). Sources used to fund these assets include deposits and borrowed funds. Net interest income is affected by changes in interest rates, the volume and mix of earning assets and interest-bearing liabilities, and the amount of earning assets funded by non-interest bearing deposits.

For purposes of this discussion, interest income and the average yield earned on loans and investment securities are adjusted to a tax-equivalent basis as detailed in the table that appears above. This adjustment to interest income is made for analysis purposes only. Interest income is increased by the amount of savings of Federal income taxes, which QNB realizes by investing in certain tax-exempt state and municipal securities and by making loans to certain tax-exempt organizations. In this way, the ultimate economic impact of earnings from various assets can be more easily compared.

The net interest rate spread is the difference between average rates received on earning assets and average rates paid on interest-bearing liabilities, while the net interest margin, which includes interest-free sources of funds, is net interest income expressed as a percentage of average interest-earning assets. The Asset/Liability and Investment Management Committee works to manage and maximize the net interest margin for the Company.

Net interest income increased $575,000, or 2.3%, to $26,126,000 for 2014. On a tax-equivalent basis, net interest income for 2014 increased $515,000, or 1.9%, to $28,029,000. The net interest margin for 2014 was 3.07% compared to 3.09% for 2013. The net interest margin was negatively impacted by declining yields on earning assets resulting from the prolonged low interest rate environment. The average rate earned on earning assets declined nine basis points from 3.66% for 2013 to 3.57% for 2014 with the yield on loans declining by 26 basis points while the yield on investment securities increased one basis point. In comparison, the interest rate paid on total average interest-bearing liabilities declined by seven basis points from 0.65% for 2013 to 0.58% for 2014 with the average rate paid on interest-bearing deposits declining six basis points from 0.64% to 0.58% over the same time period.

The chart below details the highs and lows of certain Treasury rates during the year as well as a comparison of rates at year-end 2014 and 2013. In 2014, the Treasury yield curve flattened, with the 10 year rate declining 84 basis points and the two year climbed 29 basis points. While still upward-sloping, a flatter yield curve provides decreasing spreads between earning asset yields and funding costs.

Net interest income and net interest margin continue to be negatively impacted by declining yields on earning assets resulting from the prolonged low interest rate environment that banks have been operating in since 2008, the beginning of the financial crisis. During the beginning of this interest rate cycle, funding costs declined at a faster pace and to a greater degree than rates on earning assets resulting in an increasing net interest margin. However, since the second quarter of 2011 this trend has reversed as funding costs have approached bottom while yields on earning assets continue to reprice lower resulting in a decline in the net interest margin. The competitive local interest rate market for quality loans has also negatively impacted net interest income and net interest margin. Partially offsetting the impact of declining yields on earning assets was growth in earning assets, primarily loans. Average earning assets increased by $22,544,000, or 2.5%, to $912,826,000 for 2014, with average loans increasing $41,205,000, or 8.5%, to $524,127,000, while average investment securities decreased $31,219,000, or 7.9%, to $363,204,000. However, with the growth in earning assets occurring primarily in the loan portfolio, the mix of earning assets changed which also contributed to relative stability of the net interest margin, as investment securities generally earn a lower yield than loans. The growth in loans was also funded by a $20,245,000, or 2.5%, increase in average total deposits to $829,084,000. All categories of deposits experienced increases in average balances in 2014, with the exception of Money market balances and time deposits.

Average Balances, Rates, and Interest Income and Expense Summary ***(Tax-Equivalent Basis)***

	2014 Average balance	**Average rate**	**Interest**	**2013 Average balance**	**Average rate**	**Interest**	**2012 Average balance**	**Average rate**	**Interest**
Assets									
Trading securities	$4,064	5.87 %	$239	-	-	-	-	-	-
Investment securities (AFS & HTM):									
U.S. Government agencies	60,080	1.52	915	$82,378	1.28 %	$1,057	$80,470	1.42 %	$1,144
State and municipal	77,153	4.36	3,367	86,920	4.68	4,064	79,612	5.36	4,267
Mortgage-backed and CMOs	210,336	2.03	4,276	213,303	2.05	4,370	197,666	2.44	4,813
Pooled trust preferred	3,519	0.17	6	3,519	0.18	6	3,573	0.36	13
Corporate debt	6,008	1.12	67	4,221	1.86	79	2,457	4.07	100
Equities	6,108	3.17	193	4,082	3.28	134	3,613	4.25	153
Total investment securities	363,204	2.43	8,824	394,423	2.46	9,710	367,391	2.86	10,490
Loans:									
Commercial real estate	265,512	4.55	12,084	251,037	4.86	12,198	253,029	5.30	13,398
Residential real estate	34,123	4.21	1,436	28,696	4.48	1,285	27,708	4.99	1,383
Home equity loans	56,249	3.78	2,125	52,418	4.06	2,131	51,158	4.40	2,253
Commercial and industrial	113,155	4.35	4,921	105,470	4.26	4,493	101,421	4.67	4,733
Indirect lease financing	7,779	9.95	774	9,261	9.90	916	11,282	9.88	1,115
Consumer loans	3,749	5.60	210	2,372	6.43	152	2,175	10.08	219
Tax-exempt loans	43,560	4.21	1,834	33,668	4.80	1,615	34,099	5.38	1,834
Total loans, net of unearned income*	524,127	4.46	23,384	482,922	4.72	22,790	480,872	5.19	24,935
Other earning assets	21,431	0.59	126	12,937	0.37	47	14,449	0.27	39
Total earning assets	912,826	3.57	32,573	890,282	3.66	32,547	862,712	4.11	35,464
Cash and due from banks	11,621			11,473			11,151		
Allowance for loan losses	(8,672)			(9,308)			(9,582)		
Other assets	32,089			30,741			29,195		
Total assets	$947,864			$923,188			$893,476		
Liabilities and Shareholders' Equity									
Interest-bearing deposits:									
Interest-bearing demand	$118,631	0.23 %	$274	$109,383	0.24 %	$260	$98,351	0.30 %	$291

Municipals	120,540	0.33	399	104,314	0.37	389	72,464	0.50	364
Money market	58,333	0.22	126	65,744	0.20	133	77,269	0.30	231
Savings	208,629	0.37	770	202,053	0.41	820	188,716	0.60	1,141
Time	151,002	1.08	1,636	162,837	1.16	1,882	180,293	1.33	2,391
Time of $100,000 or more	91,522	1.26	1,155	91,124	1.31	1,189	101,579	1.43	1,454
Total interest-bearing deposits	748,657	0.58	4,360	735,455	0.64	4,673	718,672	0.82	5,872
Short-term borrowings	31,616	0.36	114	29,743	0.37	111	24,847	0.44	109
Long-term debt	1,452	4.76	70	5,174	4.75	249	9,678	4.75	467
Total interest-bearing liabilities	781,725	0.58	4,544	770,372	0.65	5,033	753,197	0.86	6,448
Non-interest-bearing deposits	80,427			73,384			67,112		
Other liabilities	3,089			2,769			2,971		
Shareholders' equity	82,623			76,663			70,196		
Total liabilities and shareholders' equity	$947,864			$923,188			$893,476		
Net interest rate spread		2.99 %			3.01 %			3.25 %	
Margin/net interest income		3.07 %	$28,029		3.09 %	$27,514		3.36 %	$29,016

Tax-exempt securities and loans were adjusted to a tax-equivalent basis and are based on the marginal Federal corporate tax rate of 34 percent.

Non-accrual loans and investment securities are included in earning assets.

* Includes loans held-for-sale

Rate-Volume Analysis of Changes in Net Interest Income (1) (2) (3)

	2014 vs. 2013			2013 vs. 2012		
	Due to change in:		Total	Due to change in:		Total
	Volume	Rate	Change	Volume	Rate	Change
Interest income:						
Trading securities	$239	-	$ 239	-	-	-
Investment securities (AFS & HTM):						
U.S. Government agencies	(286)	$144	(142)	$27	$(114)	$(87)
State and municipal	(457)	(240)	(697)	392	(595)	(203)
Mortgage-backed and CMOs	(60)	(34)	(94)	381	(824)	(443)
Pooled trust preferred	-	-	-	(1)	(6)	(7)
Corporate debt	33	(45)	(12)	72	(93)	(21)
Equities	66	(7)	59	20	(39)	(19)
Total investment securities (AFS & HTM)	(704)	(182)	(886)	891	(1,671)	(780)
Loans:						
Commercial real estate	703	(817)	(114)	(105)	(1,095)	(1,200)
Residential real estate	242	(91)	151	50	(148)	(98)
Home equity loans	155	(161)	(6)	56	(178)	(122)
Commercial and industrial	327	101	428	189	(429)	(240)
Indirect lease financing	(146)	4	(142)	(200)	1	(199)
Consumer loans	89	(31)	58	20	(87)	(67)
Tax-exempt loans	475	(256)	219	(23)	(196)	(219)
Total loans	1,845	(1,251)	594	(13)	(2,132)	(2,145)
Other earning assets	32	47	79	(4)	12	8
Total interest income	1,412	(1,386)	26	874	(3,791)	(2,917)
Interest expense:						
Interest-bearing demand	22	(8)	14	32	(63)	(31)
Municipals	61	(51)	10	160	(135)	25
Money market	(15)	8	(7)	(34)	(64)	(98)
Savings	26	(76)	(50)	81	(402)	(321)
Time	(136)	(110)	(246)	(231)	(278)	(509)
Time of $100,000 or more	6	(40)	(34)	(150)	(115)	(265)
Total interest-bearing deposits	(36)	(277)	(313)	(142)	(1,057)	(1,199)
Short-term borrowings	6	(3)	3	22	(20)	2
Long-term debt	(179)	-	(179)	(218)	-	(218)
Total interest expense	(209)	(280)	(489)	(338)	(1,077)	(1,415)
Net interest income	$1,621	$(1,106)	$ 515	$1,212	$(2,714)	$(1,502)

(1) Loan fees have been included in the change in interest income totals presented. Non-accrual loans and investment securities have been included in average balances.

(2) Changes due to both volume and rates have been allocated in proportion to the relationship of the dollar amount change in each.

(3) Interest income on loans and securities is presented on a tax-equivalent basis.

The Rate-Volume Analysis tables, as presented on a tax-equivalent basis, highlight the impact of changing rates and volumes on interest income and interest expense. Total interest income on a tax-equivalent basis increased $26,000 to $32,573,000 for 2014, while total interest expense decreased $489,000, or 9.7%, to $4,544,000. Volume growth in earning assets contributed an additional $1,412,000 of interest income which was offset in part by a decline in interest income of $1,386,000 resulting from lower interest rates. With regard to interest expense, lower funding costs resulted in a decline in interest expense of $280,000. The maturity and payoff of long-term debt in April 2014 contributed to a decline in interest expense of $179,000 when comparing the two years.

The yield on earning assets on a tax-equivalent basis decreased nine basis points from 3.66% for 2013 to 3.57% for 2014. The long period of historically low interest rates has resulted in a significant amount of higher yielding bonds with call features being called and prepayments on mortgage-related securities increasing, with these proceeds being reinvested in lower yielding investment securities. In addition, new loans are being originated at significantly lower rates, variable rate loans are repricing lower and some fixed rate loans are being modified lower due to competitive pressure.

In comparison, the rate paid on interest-bearing liabilities decreased seven basis points from 0.65% for 2013 to 0.58% for 2014 with the rate paid on interest-bearing deposits decreasing six basis points from 0.64% for 2013 to 0.58% for 2014.

Interest income on trading, available-for-sale, and held-to-maturity investment securities decreased $647,000 when comparing the two years. The $27,155,000 decrease in average balances contributed to $465,000 of the decrease, while falling rates contributed the remaining $182,000 decline. Although interest income decreased, the average yield on the investment portfolio increased one basis point from 2.46% for 2013 to 2.47% for 2014. This is due in part to the establishment of a trading account consisting of municipal securities with an average balance of $4,064,000 in 2014 and an average rate of return of 5.87%. The decrease in the investment portfolio is due to lower yielding investment opportunities in 2014 compared to previous periods, as well as higher demand for loans.

Income on Government agency securities decreased $142,000, even as the yield on the portfolio increased by 24 basis points from 1.28% for 2013 to 1.52% for 2014, as investments in this sector had slightly better yields than previously available. Most of the bonds in the agency portfolio have call features ranging from three months to three years, many of which were exercised as a result of the low interest rate environment.

Interest income on tax-exempt municipal securities decreased $697,000. Average balances, which declined $9,767,000, or 11.2%, contributed $457,000 to the decrease in interest income and the 32 basis point decline in yield from 4.68% in 2013 to 4.36% in 2014 contributed the remaining $240,000 reduction in interest income. QNB had purchased many municipal securities when rates were significantly higher. Many of these bonds have either reached maturity or their call dates and are being replaced with municipal bonds with lower yields. Typically QNB purchased municipal bonds with 10-15 year maturities; however, given the current rate environment has shortened the maturity range to between 5-7 years with call dates between 2-4 years. The yield on this portfolio is expected to continue to decline as there are $15,800,000 in municipal bonds with a tax-equivalent yield of 4.38% that are expected to be called or mature in 2015. The current yield on replacement bonds is well below this threshold.

All of the mortgage-backed and collateralized mortgage obligations (“CMO”) securities owned by QNB are issued by U.S. Government agencies and sponsored enterprises (GSEs) and carry the implicit backing of the U.S. Government, but they are not direct obligations of the U.S. Government. Interest income on mortgage-backed securities and CMOs decreased $94,000 with a small decrease in average balances as well as lower rates contributing to the decline. Average balances decreased $2,967,000, or 1.4%, to $210,336,000 when comparing the two years, resulting in a $60,000 decline in interest income. The yield on the mortgage-backed and CMO portfolio decreased two basis points from 2.05% for 2013 to 2.03% for 2014, resulting in a $34,000 reduction in interest income. With the historically low interest rate environment mortgage refinancing activity over the past three years was significant resulting in an increase in prepayments on these securities. Since most of these securities were purchased at a premium, prepayments result in a shorter amortization period of this premium and therefore a reduction in income.

The largest category of the loan portfolio is commercial real estate loans. This category of loans includes commercial purpose loans secured by either commercial properties such as office buildings, factories, warehouses, medical facilities and retail establishments, or residential real estate, usually the residence of the business owner or investment properties. The category also includes construction and land development loans. Income on commercial real estate loans decreased $114,000. The increase in average balances of $14,475,000 or 5.8%, contributed an increase in interest income of $703,000. This was offset by a 31 basis point decline in yield, from 4.86% in 2013 to 4.55% in

2014, which resulted in a decrease of interest income of $817,000.

Income on commercial and industrial loans, the second largest category, increased $428,000 with the positive impact from growth in balances being as well as improved yield. Average commercial and industrial loans increased $7,685,000, or 7.3%, to $113,155,000 for 2014, providing an additional $327,000 in interest income. Average yield on these loans increased nine basis points to 4.35% resulting in an increase in interest income of $101,000.

Tax-exempt loan income was $1,834,000 for 2014, an increase of $219,000 from 2013. When comparing the same periods average balances increased 29.4% to $43,560,000, which contributed a $475,000 increase in interest income. With the decline in market interest rates QNB has renegotiated and rebid on many loans to municipalities over the past several years. As a result, the average yield on the tax-exempt loan portfolio has declined from 4.80% for 2013 to 4.21% for 2014, resulting in decreased interest income of $256,000.The increase in volume related interest income of $475,000 partially offset the yield decrease when comparing the two years.

Indirect lease financing receivables represent loans to small businesses that are collateralized by equipment. These loans tend to have higher risk characteristics but generally provide higher rates of return. These loans are originated by a third party and purchased by QNB based on criteria specified by QNB. The criteria include minimum credit scores of the borrower, term of the lease, type and age of equipment financed and geographic area. The geographic area primarily represents states contiguous to Pennsylvania. QNB is not the lessor and does not service these loans. As a result of these higher returns the market for these types of loans has become extremely competitive both in terms of rate and quality available and as a result QNB has purchased fewer leases. Lease financing income was $774,000 for 2014, a decrease of $142,000 when compared to the $916,000 reported for 2013. Average balances declined by $1,482,000 or 16.0%, resulting in a reduction in income of $146,000 when comparing the two years. The yield on the portfolio improved slightly to 9.95% in 2014, compared to 9.90% for 2013, slightly offsetting the volume-related decline in income by $4,000. Early payoff on leases often results in the recognition of additional income.

QNB strives to become the “local consumer lender of choice” and to affect this QNB has refocused its retail lending efforts by strengthening the management of the area, adding new product offerings and by increasing marketing and promotion. The positive impact of this renewed focus has been year-over-year growth in balances in all three categories of retail lending: residential mortgage, home equity and consumer loans. Overall, interest income for retail lending increased $203,000 in 2014 compared to 2013, driven by the increase in average balances.

Income on home equity loans declined by $6,000 when comparing 2014 and 2013. During 2014 QNB offered attractive rates on both variable rate and fixed rate home equity loans, which contributed to an increase in average balances totaling $3,831,000, or 7.3%, to $56,249,000 when comparing 2014 and 2013. The yield on the home equity portfolio decreased 28 basis points to 3.78% when comparing the two years. The demand for home equity loans declined during prior periods as home values fell preventing some homeowners from having equity in their homes to borrow against while others took advantage of the low interest rates on mortgages and refinanced their home equity loans into a new mortgage. With an improvement in home values it is expected that the demand for home equity loans will continue.

Given the low yields on alternative investment securities management decided to retain certain hybrid adjustable rate mortgages to borrowers with high credit scores and low loan-to-value ratios. As a result, average residential mortgage loans secured by first lien 1-4 family residential mortgages increased by $5,427,000, or 18.9%, to $34,123,000 for 2014. The average yield on the residential real estate portfolio decreased by 27 basis points to 4.21% for 2014. Overall, interest income for this segment grew $151,000 in 2014.

Interest income on consumer loans increased $58,000. As with all other categories of retail loans, consumer loans at QNB experienced growth in average balances in 2014, with balances in this segment increasing $1,377,000, or 58.1%. This growth in volume contributed $89,000 to the increase in income, while decline in yield from 6.43% in 2013 to 5.60% offset the volume increase by $31,000. In 2014 QNB marketed auto loans, offering a competitive rate, driving loan demand.

Earning assets are funded primarily by deposits, which increased on average by $20,245,000, or 2.5%, to $829,084,000, when comparing 2014 and 2013. This follows an increase of $23,055,000, or 2.9%, between 2012 and 2013. Total interest expense for 2014 was $4,544,000 compared to $5,033,000 for 2013, a decline of $489,000. Interest expense on total deposits decreased $313,000 while interest expense on borrowed funds decreased $176,000 when comparing the two years. The rate paid on interest-bearing liabilities decreased seven basis points from 0.65% for 2013 to 0.58% for 2014. During this same period, the rate paid on interest-bearing deposits decreased six basis points from 0.64% to 0.58%. These yields will most likely not decline much further as deposit rates are close to reaching an inherent floor and may actually begin to increase as short-term interest rates begin to rise and the competition for deposits increases.

Similar to the past two years, the growth in deposits during 2014 was centered in accounts with greater liquidity, such as non-interest and interest-bearing demand, interest-bearing municipal accounts, and savings deposits. Average non-interest-bearing demand accounts increased $7,043,000, or 9.6%, to $80,427,000 for 2014. QNB has been very successful in increasing business checking accounts as average balances in these accounts have increased by $7,481,000, or 13.2%, when comparing the two years. Average interest-bearing demand accounts increased $9,248,000, or 8.5%, to $118,631,000 for 2014 compared to 2013 with interest expense on interest-bearing demand accounts increasing $14,000 to $274,000 for 2014. The average rate paid decreased one basis point from 0.24% for 2013 to 0.23% for 2014. Included in this category is QNB-Rewards checking, a higher-rate checking account product. The rate paid on balances up to $25,000 was 1.00% and 0.25% for balances over $25,000 in 2014. In order to receive the high rate a customer must receive an electronic statement, have one direct deposit or other ACH transaction and have at least 12 check card purchase transactions post and clear per statement cycle. For 2014, the average balance in this product was $36,242,000 and the related interest expense was $225,000 for an average cost of funds of 0.62%. In comparison, the average balance of the QNB-Rewards accounts for 2013 was $31,195,000 with a related interest expense of $215,000 and an average rate paid of 0.69%. Even with the reduction in the rates paid on the QNB-Rewards product, the yield of 1.00% for the first $25,000 and 0.25% on balances over $25,000, assuming qualifications are met, is still an attractive rate relative to competitors' offerings as well as other QNB products. This product also generates fee income through the use of the check card. The average balance of other interest-bearing demand accounts included in this category increased from $78,188,000 for 2013 to $82,389,000 for 2014. The average rate paid on these balances was 0.06% for both years.

Interest expense on municipal interest-bearing demand accounts increased $10,000 to $399,000 for 2014. The average balance of municipal interest-bearing demand accounts increased $16,226,000, or 15.6%, to $120,540,000, while the average interest rate paid on these accounts decreased from 0.37% for 2013 to 0.33% for 2014. Most of these accounts are indexed to the Federal funds rate with negotiated rate floors between 0.25% and 0.50%. QNB was successful in increasing its relationships with several of these customers as well as adding new municipalities and school districts over the past year, accounting for the increase in balances. Many of these deposits are seasonal in nature and are received during the third quarter as tax receipts are collected and are withdrawn over the course of the next year.

Average money market accounts decreased $7,411,000, or 11.3%, to $58,333,000 for 2014 compared with 2013. Much of the decline in money market balances is a result of a shift in these balances to interest-bearing demand accounts or eSavings accounts. Interest expense on money market accounts decreased $7,000 to $126,000 for 2014 compared to 2013. The average interest rate paid on money market accounts was 0.20% for 2013 and 0.22% for 2014, an increase of two basis points. The majority of balances in this category are in the Select money market account, a product that pays a tiered rate based on account balances. With the continuation of exceptionally low short-term interest rates, balances remaining in these accounts for 2014 were at higher-yielding tiers.

During the second quarter of 2009, QNB introduced an online eSavings account to compete with other online savings accounts. This product was introduced at a yield of 1.85% and has been successful, with average balances growing $3,715,000, or 2.4%, to $156,063,000 in 2014 compared to $152,348,000 in 2013. The rate on this product was reduced to 0.45% during 2013 and was unchanged throughout 2014. The average cost of funds on these accounts was 0.50% for 2013 compared with 0.46% for 2014, with the rate remaining at 0.45% from the end of 2013 and throughout 2014. The yield on this account may rise along with market rates and as competition for savings balances increases. Traditional statement savings accounts and club accounts are also included in the savings category and increased on average by $2,861,000, or 5.8%, to $52,566,000. The average rate paid on total savings accounts decreased four basis points from 0.41% for 2013 to 0.37% for 2014 and interest expense decreased $50,000, from $820,000 to $770,000 over the same period. The growth in balances appears to reflect the desire for liquidity and a better rate than short-term time deposits.

The repricing of time deposits at lower rates combined with the decline in average time deposit balances continues to have the greatest impact on total interest expense. Total interest expense on time deposits decreased $280,000, or 9.1%, to $2,791,000 for 2014. Average total time deposits decreased by $11,437,000, or 4.5%, to $242,524,000 for 2014. Similar to fixed-rate loans and investment securities, time deposits reprice over time and, therefore, have less of an immediate impact on costs in either a rising or falling rate environment. Unlike loans and investment securities, however, the maturity and repricing characteristics of time deposits tend to be shorter. The average rate paid on time deposits decreased from 1.21% to 1.15% when comparing 2013 to 2014.

Approximately $115,347,000, or 47.4%, of time deposits at December 31, 2014 will reprice or mature over the next 12 months, compared with 42.3% of the portfolio at December 31, 2013. The average rate paid on these time deposits is approximately 0.79%. QNB has been trying to lengthen the maturity of the time deposit portfolio by offering attractive rates at terms 36 months or greater, with moderate success. The yield on the time deposit portfolio may decline slightly in the next quarter as short-term time deposits reprice. However, given the short-term nature of these deposits interest expense could increase if short-term time deposit rates were to increase suddenly or if customers select higher paying longer term time deposits.

Short-term borrowings are comprised of sweep accounts structured as repurchase agreements with our commercial customers and overnight borrowings from the correspondent banks with average balances in 2014 of $29,574,000 and $2,042,000, respectively. Interest expense on short-term borrowings increased by $3,000 to $114,000 when comparing the two years. During this period average balances increased $1,873,000 to $31,616,000 while the average rate paid declined one basis point, from 0.37% to 0.36%.

Contributing to the decrease in total interest expense was a reduction in interest expense on long-term debt of $179,000. The average balance of long-term debt for 2014 was $1,452,000 compared with $5,174,000 in 2013. The final portion of long-term debt taken out in April 2012 matured and was repaid on April 17, 2014. The rate on this long-term debt was 4.75%.

Provision for Loan Losses

The provision for loan losses represents management's determination of the amount necessary to be charged to operations to bring the allowance for loan losses to a level that represents management's best estimate of the known and inherent losses in the existing loan portfolio. QNB recorded a provision for loan losses of $400,000 for each of the twelve month periods ended December 31, 2014 and December 31, 2013. The provision for loan losses reflects the reduction in classified loans and nonperforming loans, and a reduction in specific impairment reserves. Net loan charge-offs were $1,324,000, or 0.25% of total average loans for 2014 compared with $1,247,000, or 0.26% of total average loans in 2013. The majority of the loans charged off during 2014 had specific reserves established during the allowance for loan loss calculation process prior to the ultimate decision to charge-off the loans. Deterioration in credit quality or significant growth in the loan portfolio could result in a higher provision for loan losses in 2015.

Non-interest income comparison

			Change from prior year	
Year Ended December 31,	**2014**	**2013**	**Amount**	**Percent**
Fees for services to customers	$1,687	$1,594	$93	5.8 %
ATM and debit card	1,485	1,499	(14)	-0.9
Retail brokerage and advisory	657	523	134	25.6
Bank-owned life insurance	472	320	152	47.5
Merchant	299	367	(68)	-18.5
Net gain on trading activities	156	-	156	-
Net gain on invesment securities	1,112	824	288	35.0
Net gain on sale of loans	258	425	(167)	-39.3
Gain on sale of internet domain name	1,000	-	1,000	-
Other	416	261	155	59.4
Total	$7,542	$5,813	$1,729	29.7 %

Non-Interest Income

QNB, through its core banking business, generates various fees and service charges. Total non-interest income includes service charges on deposit accounts, ATM and check card income, retail brokerage and advisory income, income on bank-owned life insurance, merchant income and gains and losses on investment securities and residential mortgage loans. On November 26, 2014, QNB transferred its former internet domain name to a third party for a purchase price of $1,000,000, as disclosed in a Form 8-K filing dated December 2, 2014. The Company also received a life insurance benefit totaling $158,000 during the fourth quarter. Total non-interest income was $7,542,000 in 2014 compared with $5,813,000 in 2013, an increase of $1,729,000, or 29.7%. Excluding these two non-recurring items, the Company posted an increase in non-interest income of $571,000, or 9.8%, for the twelve months ended of 2014, compared to the same period in 2013.

Fees for services to customers are primarily comprised of service charges on deposit accounts. These fees were $1,687,000 for 2014, an increase of $93,000, or 5.8%, from 2013. Overdraft income, which represented approximately 72% and 69% of total fees for services to customers in 2014 and 2013, respectively, increased by $115,000, or 10.5%, when comparing 2014 to 2013. The increase in overdraft income primarily reflects growth in the number of checking accounts as well as the positive impact of the introduction of an overdraft protection program on net overdraft income as the program reduced the amount of overdraft fees forgiven.

ATM and debit card income is primarily comprised of transaction income on debit cards and ATM cards and ATM surcharge income for the use of QNB's ATM machines by non-QNB customers. ATM and debit card income was $1,485,000 in 2014, a decrease of $14,000, or 0.9%, from the amount recorded in 2013. Debit card income increased $88,000, or 7.5%, to $1,261,000 in 2014, while ATM interchange income decreased $101,000, or 39.2%, to $156,000. The Dodd-Frank Act and the Durbin amendment impacted both the total amount of interchange income received on debit and ATM transactions as well as the distribution between the two as merchants began routing their transactions through the low cost provider. The growth in checking accounts contributed to the increase in debit card income, including the QNB Rewards checking product, a high-yield checking account which requires, among other terms, the posting of a minimum of twelve debit card purchase transactions per statement cycle to receive the high interest rate. Multiple high profile data breaches at national retailers throughout 2014 may have a negative impact on the volume of debit and credit card transactions and therefore income generated, as shoppers may lose confidence in the security of these cards and may alter their behavior and use cash more frequently.

Retail brokerage and advisory revenue was $657,000 for 2014 compared to $523,000 in 2013. QNB provides securities and advisory services under the name QNB Financial Services through Investment Professionals, Inc., a registered Broker/Dealer and Registered Investment Advisor. QNB receives 75% to 86% of the revenue generated, depending on volume but is also responsible for salaries and expenses of two advisors who are QNB employees. In 2014, the net amount of income provided by these services was $112,000, compared to $74,000 in net income for 2013.

Income on bank-owned life insurance (BOLI) represents the earnings and death benefits on life insurance policies in which the Bank is the beneficiary. The insurance carriers reset the rates on these policies annually taking into consideration the interest rate environment as well as mortality costs. The existing policies have rate floors which minimize how low the earnings rate can go. Some of these policies are currently at their floor. Income on these policies during 2014 was $472,000, including $158,000 related to a death claim. Excluding the claim, income in 2014 would be $314,000, compared to $320,000 in 2013, with the decline in income resulting from a decrease in the earning credit rate from one carrier and increases in mortality costs.

Merchant income represents fees charged to merchants for the Bank's handling of credit card or charge sales. Merchant income was $299,000 for 2014, a decrease of $68,000, or 18.5%, from the amount reported in 2013. The decrease in merchant income is primarily a result of extremely competitive pricing in the market. Sales volume decreased approximately 10.1% year over year, due to the loss of three vendors to competition, the acquisition of new clients at smaller margins and possible change in card-holders' behavior due to multiple data breaches in 2014. QNB had 251 merchant customers at December 31, 2014 and 247 merchant customers at December 31, 2013.

The fixed-income securities portfolio represents a significant portion of QNB's earning assets and is also a primary tool in liquidity and asset/liability management. QNB actively manages its fixed-income portfolio in an effort to take advantage of changes in the shape of the yield curve, changes in spread relationships in different sectors, and for liquidity purposes. Management continually reviews strategies that will result in an increase in the yield or improvement in the structure of the investment portfolio, including monitoring credit and concentration risk in the portfolio. In addition the Corporation owns a small portfolio of equity securities for the purpose of generating both dividend income and capital appreciation.

Net investment securities gains were $1,112,000 for 2014 compared to $824,000 for 2013. Included in these figures were gains from equity securities of $1,045,000 and $629,000, in 2014 and 2013, respectively. The 2013 net gains were comprised of $672,000 realized on the sales of equity securities reduced by an other-than-temporary impairment (OTTI) charge of $43,000. There were no OTTI charges in 2014. With the outstanding performance in the U.S. equity markets during 2013 and 2014, QNB elected to sell some equity holdings and recognize gains. Gains on the sale of fixed income securities were $67,000 and $195,000 for 2014 and 2013, respectively. Both the 2014 and 2013 fixed income gains were primarily from the sale of fast paying or odd-lot mortgage-backed and CMO securities as well as low yielding agency bonds that were likely to be called in the next two years.

The net gain on residential mortgage sales is directly related to the volume of mortgages sold and the timing of the sales relative to the interest rate environment. Residential mortgage loans to be sold are identified at origination. The net gain on the sale of residential mortgage loans was $258,000 and $425,000 for 2014 and 2013, respectively. Mortgage refinance activity slowed significantly beginning in June 2013 and continued through the first six months of 2014 due to higher mortgage rates as well as contraction in GDP during the first quarter 2014. Proceeds from the sale of residential mortgages were $6,589,000 and $17,022,000. Included in the gains on the sale of residential mortgages in 2014 and 2013 are $48,000 and $126,000, respectively, related to the recognition of mortgage servicing assets.

When QNB sells its residential mortgages in the secondary market, it retains servicing rights. A normal servicing fee is retained on all mortgage loans sold and serviced. QNB recognizes its obligation to service financial assets that are retained in a transfer of assets in the form of a servicing asset. The servicing asset is amortized in proportion to, and over, the period of net servicing income or loss. On a quarterly basis, servicing assets are assessed for impairment based on their fair value. Mortgage servicing income of $135,000 for 2014 and $152,000 for 2013 is included in other non-interest income.

Other non-interest income was $416,000 for 2014, an increase of $155,000 from the amount recorded in 2013. There were no OREO sales in 2014, compared to a $174,000 loss on sale of OREO in 2013. In addition, the Company received $30,000 in rental income for an OREO property in 2014. QNB receives income from its membership in Laurel Abstract Company LLC. This income from the title company decreased by $61,000 to $13,000 when comparing the two years, due to the slowdown in mortgage refinance activity in 2014 compared to 2013.

Non-interest expense comparison

			Change from prior year	
Year ended December 31,	**2014**	**2013**	**Amount**	**Percent**
Salaries and employee benefits	$11,649	$10,553	$1,096	10.4 %
Net occupancy	1,705	1,638	67	4.1
Furniture and equipment	1,753	1,714	39	2.3
Marketing	841	971	(130)	-13.4
Third party services	1,677	1,488	189	12.7
Telephone, postage and supplies	730	670	60	9.0
State taxes	617	690	(73)	-10.6
FDIC insurance premiums	686	705	(19)	-2.7
Other	1,968	1,797	171	9.5
Total	$21,626	$20,226	$1,400	6.9 %

Non-Interest Expense

Non-interest expense is comprised of costs related to salaries and employee benefits, net occupancy, furniture and equipment, marketing, third party services, FDIC insurance premiums, regulatory assessments and taxes and various other operating expenses. Total non-interest expense was $21,626,000 in 2014, an increase of $1,400,000, or 6.9%, from the $20,226,000 recorded in 2013. QNB's overhead efficiency ratio, which represents the percentage of each dollar of revenue that is used for non-interest expense, is calculated by taking non-interest expense divided by net operating revenue. The Bank's efficiency ratios for 2014 and 2013 were 65.9% and 65.7%, respectively, and compare favorably with Pennsylvania state-chartered commercial banks with assets between $750 million and $1.5 billion which had average efficiency ratios of 67.9% and 66.7% for 2014 and 2013, respectively.

Salaries and benefits expense is the largest component of non-interest expense. QNB monitors, through the use of various surveys, the competitive salary and benefit information in its markets and makes adjustments when appropriate. Salaries and benefits expense for 2014 was $11,649,000, an increase of $1,096,000, or 10.4%, over the $10,553,000 reported in 2013. Salary expense for 2014 was $8,965,000, an increase of $529,000, or 6.3%, over the $8,436,000 reported in 2013. Included in salary expense in 2014 was incentive compensation plus related payroll taxes of $282,000. There was no incentive compensation recorded during 2013. Excluding the cost of incentive compensation, salary expense increased $247,000, or 2.9%, when comparing 2014 to 2013. Benefit expense for 2014 was $2,684,000, an increase of $567,000, or 26.8%, from the amount recorded in 2013, with medical benefits increasing $470,000, or 48.8%, related to a number of large claims. QNB self-funds medical insurance and also has Stop Loss insurance which limits its claims expense. Payroll taxes and retirement plan matching and safe harbor and other benefits increased $98,000 in 2014.

Net occupancy and furniture and equipment expense increased $106,000, or 3.2%, to $3,458,000 when comparing 2014 to 2013. This is related to a $45,000 increase in equipment maintenance costs coupled with higher depreciation and amortization expense on buildings, new furniture, equipment and software.

Marketing expense was $841,000 for 2014, a decrease of $130,000, or 13.4%, from the $971,000 recorded in 2013. Marketing expenses related to advertising, public relations, research and sales promotion decreased $58,000 for the year ended December 31, 2014 compared to 2013. The opening of the two new branch locations and the introduction of QNB Financial Services were the primary contributors to the increase in these categories in 2013. A reduction in charitable contributions of $72,000 also contributed to the decrease in the marketing expense category. QNB contributes to many not-for-profit organizations and clubs and sponsors many local events in the communities it serves.

Telephone, postage and supplies expense was $60,000, or 9.0%, higher for 2014 than 2013 with communication costs which include telephone and internet costs accounting for the increase. An increase in bandwidth to provide faster communications to our branch locations contributed to this cost increase.

State tax expense represents the payment of the Pennsylvania Shares Tax, Pennsylvania sales and use tax and the Pennsylvania capital stock tax. State tax expense was $617,000 and $690,000 for the years 2014 and 2013, respectively. The Pennsylvania Shares Tax is based primarily on the equity of the Bank and makes up the majority of the expense in this category. The decline from prior the prior year is a result of a change in the state-mandated formula for 2014, which resulted in lower tax expense despite increased Bank equity.

Income Taxes

Applicable income taxes and effective tax rates were $2,644,000, or 22.7%, for 2014 compared to $2,346,000, or 21.8%, for 2013. The higher effective tax rate for 2014 is predominately a result of tax-exempt income from loans and securities comprising a smaller proportional share of pre-tax income. For a more comprehensive analysis of income tax expense and deferred taxes, refer to Note 11 in the Notes to Consolidated Financial Statements.

Financial Condition

ASSETS

The following table presents total assets at the dates indicated:

			Change from prior year	
Year ended December 31,	**2014**	**2013**	**Amount**	**Percent**
Cash and cash equivalents	$18,245	$16,286	$1,959	12.0 %
Investment securities	379,572	388,816	(9,244)	-2.4
Restricted investment in bank stocks	647	1,764	(1,117)	-63.3
Loans held-for-sale	380	-	380	-
Loans receivable	555,282	501,716	53,566	10.7
Allowance for loan losses	(8,001)	(8,925)	924	-10.4
Premises and equipment, net	9,702	9,875	(173)	-1.8
Bank-owned life insurance	10,658	10,407	251	2.4
Accrued interest receivable	2,568	2,579	(11)	-0.4
Other assets	8,082	10,365	(2,283)	-22.0
Total assets	$977,135	$932,883	$44,252	4.7 %

Cash and interest-earnings deposits

Total cash and cash equivalents increased $1,959,000 from $16,286,000 at December 31, 2013 to $18,245,000 at December 31, 2014. QNB had interest bearing balances at the Federal Reserve Bank of $5,930,000 at December 31, 2014 compared with $3,544,000 at December 31, 2013.

Investment Securities and Other Short-Term Investments

At December 31, 2014 and 2013, QNB had no Federal funds sold. With the Federal funds rate to between 0.0% and 0.25%, excess funds for liquidity purposes are kept at the Federal Reserve which was paying 0.25% and carries a 0% risk weighting for risk-based capital calculation purposes.

Investment Portfolio History

December 31,	**2014**	**2013**	**2012**
Trading Securities			
State and municipal	$4,207	$ -	$ -
Total trading securities	$4,207	$ -	$ -
Investment Securities Available-for-Sale			
U.S. Government agency	$62,665	$ 71,639	$ 104,130
State and municipal	72,569	87,199	86,789
U.S. Government agencies and sponsored enterprises (GSEs):			
Mortgage-backed	136,192	139,723	107,973
Collateralized mortgage obligations (CMOs)	87,662	75,394	94,091
Pooled trust preferred	2,439	2,069	1,962
Corporate debt	6,037	6,021	2,502
Equity	7,655	6,625	4,055
Total investment securities available-for-sale	$375,219	$ 388,670	$ 401,502
Investment Securities Held-to-Maturity			
State and municipal	$146	$ 146	$ 146
Total investment securities held-to-maturity	$146	$ 146	$ 146
Total investment securities	$379,572	$ 388,816	$ 401,648

The total carrying amount of investment securities at December 31, 2014 and 2013 was $379,572,000 and $388,816,000, respectively. For both periods, approximately 75% of QNB's investment securities were either U.S. Government agency debt securities, U.S. Government agency issued mortgage-backed securities or CMOs. As of December 31, 2014, QNB held no securities of any one issue or any one issuer (excluding the U.S. Government and its agencies) that were in excess of 10% of shareholders' equity.

The QNB investment portfolio represents a significant portion of earning assets and interest income. QNB actively manages the investment portfolio in an attempt to maximize earnings, while considering liquidity needs, interest rate risk and credit risk. Proceeds from the sale of investments were $29,972,000 in 2014 compared to $19,559,000 during 2013.

In addition to the proceeds from the sale of investment securities, proceeds from maturities, calls and prepayments of securities were $82,360,000 in 2014, compared with $110,123,000 in 2013. The significant amount of proceeds in both years reflects the low interest rate environment that has existed for approximately the past six years which resulted in a significant amount of agency and municipal bonds being called as well an increase in the amount of prepayments on mortgage-backed securities and CMOs. The reduction of the investment portfolio as a percent of total assets in 2014 accounts for the decrease in cash flow from sales, calls and prepayments compared to 2013. Strong loan demand resulted in a reduction in the amount of bonds purchased in 2014 compared to recent years. During 2014, $92,017,000 of investment securities were purchased compared with $130,213,000 during 2013.

U.S. Government agency issued CMOs grew $12,268,000 to $87,662,000 at December 31, 2014, representing 23.1% of the investment portfolio compared to 19.4% at December 31, 2013. This sector was increased because these bonds provide monthly cash flow to be reinvested in either loans or other securities, potentially at higher yields should rates increase. The balance of U.S. Government agency securities decreased by $8,974,000 to $62,665,000 at December 31, 2014 and represents 16.5% of the portfolio compared to 18.4% at December 31, 2013. Many of the bonds called were in the agency portfolio and the decision was made not to reinvest the proceeds back into this portfolio because of the low yields relative to amortizing securities and the lack of monthly cash flow that mortgage-backed securities provide. U.S. Government agency mortgage-backed securities decreased $3,531,000, remaining approximately 35.9% of the total portfolio at December 31, 2014 and 2013.

The balance of municipal securities decreased $10,423,000 to $76,776,000 -- $4,207,000 in trading and $72,569,000 in available for sale -- at December 31, 2014, representing 20.2% of the investment portfolio compared to 22.4% at December 31, 2013. When QNB purchases a municipal security it focuses on the financial performance of the underlying issuer not just the bond rating of the issuer or the rating of bond insurer, if present. Thirty-nine bonds with a par value of $14,425,000 were called in 2014 and purchased municipal securities had significantly lower yields then the bonds they replaced which contributed to the decline in the yield on the portfolio.

QNB owns collateralized debt obligations ("CDO") in the form of pooled trust preferred securities. These securities are comprised mainly of securities issued by banks or bank holding companies, and to a lesser degree, insurance companies. In most cases, QNB owns the mezzanine tranches of these securities. These securities are structured so that the senior and mezzanine tranches are protected from defaults by over-collateralization and cash flow default protection provided by subordinated tranches. QNB holds six of these securities with an amortized cost of $3,519,000 and a fair value of $2,439,000 at December 31, 2014. All of the trust preferred securities are available-for-sale securities and are carried at fair value. There were no credit-related OTTI charges during 2014 or 2013 on these securities. Future estimates of fair value of these securities could require recording additional OTTI charges through earnings. QNB uses an independent third party to value these securities and to determine if credit-related OTTI exists. For additional detail on these securities see Notes 4 and 17 of the Notes to Consolidated Financial Statements.

QNB accounts for its investments by classifying securities into three categories. Securities that QNB has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost. Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings. Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses, net of tax, excluded from earnings and reported as a separate component of shareholders' equity. Management determines the appropriate classification of securities at the time of purchase. QNB held trading securities of $4,207,000 and an additional $1,160,000 in a brokerage cash account at December 31, 2014. QNB held no trading securities at December 31, 2013.

At December 31, 2014 and 2013, investment securities totaling $206,774,000 and $207,868,000, respectively, were pledged as collateral for repurchase agreements and public deposits.

Investment Portfolio Maturities and Weighted Average Yields

December 31, 2014	One year or less	After one year through five years	After five years through ten years	After ten years	Total
Investment Securities Available-for-Sale					
U.S. Government agency:					
Fair value	$3,034	$40,944	$18,687	-	$62,665
Weighted average yield	2.06 %	1.45 %	1.93 %	-	1.63 %
State and municipal:					
Fair value	3,789	6,990	40,388	$21,402	72,569
Weighted average yield	4.17 %	3.28 %	3.98 %	4.70 %	4.13 %
Mortgage-backed:					
Fair value	-	123,511	12,681	-	136,192
Weighted average yield	-	2.07 %	2.15 %	-	2.08 %
Collateralized mortgage obligations (CMOs):					
Fair value	2,446	85,216	-	-	87,662
Weighted average yield	2.58 %	1.78 %	-	-	1.81 %
Pooled trust preferred: (1)					
Fair value	-	-	-	2,439	2,439
Weighted average yield	-	-	-	-	-
Corporate debt:					
Fair value	-	4,022	2,015	-	6,037
Weighted average yield	-	0.99 %	1.40 %	-	1.13 %
Equity:					
Fair value	-	-	-	7,655	7,655
Weighted average yield	-	-	-	3.12 %	3.12 %
Total fair value	$9,269	$260,683	$73,771	$31,496	$375,219
Weighted average yield	3.06 %	1.90 %	3.06 %	3.82 %	2.31 %
Investment Securities Held-to-Maturity					
State and municipal:					
Amortized cost	-	$146	-	-	$146
Weighted average yield	-	6.98 %	-	-	6.98 %

Securities are assigned to categories based on stated contractual maturity except for mortgage-backed securities and CMOs which are based on anticipated payment periods and state and municipal securities which are based on pre-refunded date if applicable. Tax-exempt securities were adjusted to a tax-equivalent basis and are based on the marginal Federal corporate tax rate of 34 percent and a Tax Equity and Financial Responsibility Act (TEFRA) adjustment of four basis points. Weighted average yields on investment securities available-for-sale are based on amortized cost.

(1) All pooled trust preferred securities are on non-accrual status.

Investment Securities - Trading

In 2014, QNB established a small percentage of its investment portfolio as trading in an effort to boost yields and income. During the first quarter of 2014 QNB sold approximately $5,000,000 of available-for-sale municipal securities with the proceeds reinvested into a municipal trading account. The fair value of the trading portfolio is $4,207,000 at December 31, 2014. QNB recorded $156,000 in non-interest income comprising realized and unrealized gains for 2014.

Investments Available-For-Sale

Available-for-sale investment securities include securities that management intends to use as part of its liquidity and asset/liability management strategy. These securities may be sold in response to changes in market interest rates, changes in the securities prepayment or credit risk, the need for liquidity, or growth in loan demand. At December 31, 2014, the fair value of investment securities available-for-sale was $375,219,000, or $1,375,000 above the amortized cost of $373,844,000. This compares to a fair value of $388,670,000, or $5,170,000 below the amortized cost of $393,840,000, at December 31, 2013. Unrealized holding gains, net of tax, of $907,000 were recorded as an increase to shareholders' equity as of December 31, 2014. Unrealized holding losses, net of tax, of $3,412,000 were recorded as a decrease to shareholders' equity as of December 31, 2013. The available-for-sale portfolio, excluding equity securities and the pooled trust preferred securities, had a weighted average maturity of approximately 3.5 years at December 31, 2014 and 3.8 years at December 31, 2013. The weighted average tax-equivalent yield was 2.31% and 2.42% at December 31, 2014 and 2013, respectively.

The weighted average maturity is based on the stated contractual maturity or likely call date of all securities except for MBS and CMOs, which are based on estimated average life. The maturity of the portfolio could become shorter if interest rates declined and prepayments on MBS and CMOs increased or securities are called. However, the estimated average life could lengthen if interest rates were to increase and principal payments on MBS and CMOs slowed or securities anticipated to be called extend past their call date.

Investments Held-To-Maturity

Investment securities held-to-maturity are recorded at amortized cost. At December 31, 2014 and 2013, the amortized cost of investment securities held-to-maturity was $146,000 and $146,000, respectively, and the fair value was $156,000 and $162,000, respectively. At December 31, 2014 and 2013 there was a single municipal security in the held-to-maturity portfolio. The held-to-maturity portfolio had a weighted average maturity of approximately 1.8 years and 2.8 years at December 31, 2014 and December 31, 2013, respectively. The weighted average tax-equivalent yield was 6.98% at both December 31, 2014 and 2013.

Loans

QNB's primary business is to accept deposits and to make loans to meet the credit needs of the communities it serves. Loans are the most significant component of earning assets and growth in loans to small businesses and residents of these communities has been a primary focus of QNB. Inherent within the lending function is the evaluation and acceptance of credit risk and interest rate risk. QNB manages credit risk associated with its lending activities through portfolio diversification, underwriting policies and procedures and loan monitoring practices.

QNB has comprehensive policies and procedures that define and govern commercial loan, retail loan and indirect lease financing originations and the management of risk. All loans are underwritten in a manner that emphasizes the borrowers' capacity to pay. The measurement of capacity to pay delineates the potential risk of non-payment or default. The higher potential for default determines the need for and amount of collateral required. QNB makes unsecured commercial loans when the capacity to pay is considered substantial. As capacity lessens, collateral is required to provide a secondary source of repayment and to mitigate the risk of loss. Various policies and procedures provide guidance to the lenders on such factors as amount, terms, price, maturity and appropriate collateral levels. Each risk factor is considered critical to ensuring that QNB receives an adequate return for the risk undertaken, and that the risk of loss is minimized.

QNB manages the risk associated with commercial loans by having lenders work in tandem with credit analysts while maintaining independence between personnel. In addition, a Bank loan committee and a committee of the Board of Directors review and approve certain loan requests on a weekly basis. At December 31, 2014, there were no concentrations of loans exceeding 10% of total loans other than disclosed in the Loan Portfolio table.

QNB's commercial lending activity is focused on small businesses within the local community. Commercial purpose loans are generally perceived as having more risk of default than residential real estate loans with a personal purpose and consumer loans. These types of loans involve larger loan balances to a single borrower or group of related borrowers and are more susceptible to a risk of loss during a downturn in the business cycle. These loans may involve greater risk because the availability of funds to repay these loans depends on the successful operation of the borrower's business. The assets financed are used within the business for its ongoing operation. Repayment of these kinds of loans generally comes from the cash flow of the business or the ongoing conversions of assets, such as accounts receivable and inventory, to cash. Commercial and industrial loans represent commercial purpose loans that are either secured by collateral other than real estate or unsecured.

Commercial loans secured by commercial real estate include commercial purpose loans collateralized at least in part by commercial real estate. Some of these loans may not be for the express purpose of conducting commercial real estate transactions. Commercial loans secured by residential real estate are commercial purpose loans generally secured by the business owner's residence or residential investment properties owned by the borrower and rented to tenants. Commercial loans secured by either commercial real estate or residential real estate are originated primarily within the Eastern Pennsylvania market area, are within the Bank's underwriting criteria, and generally include the guarantee of the borrowers. Repayment of this kind of loan is dependent upon either the ongoing cash flow of the borrowing entity or the resale of or lease of the subject property. Commercial real estate and commercial construction loans may be affected to a greater extent than residential loans by adverse conditions in real estate markets or the economy because commercial real estate borrowers' ability to repay their loans depends on successful development of their properties.

Loans to state and political subdivisions are tax-exempt or taxable loans to municipalities, school districts and housing and industrial development authorities. These loans can be general obligations of the municipality or school district repaid through their taxing authority, revenue obligations repaid through the income generated by the operations of the authority, such as a water or sewer authority, or loans issued to a housing and industrial development agency, for which a private corporation is responsible for payments on the loans.

Indirect lease financing receivables represent loans to small businesses and individuals that are collateralized by equipment. These loans tend to have higher risk characteristics but generally provide higher rates of return. These loans are originated by a third party and purchased by QNB based on criteria specified by QNB. The criteria include minimum credit scores of the borrower, term of the lease, type and age of equipment financed and geographic area. The geographic area primarily represents states contiguous to Pennsylvania. QNB is not the lessor and does not service these loans.

The Company originates fixed rate and adjustable-rate residential real estate loans that are secured by the underlying 1-to-4 family residential properties. Credit risk exposure in this area of lending is minimized by the evaluation of the credit worthiness of the borrower, including debt-to-income ratios, credit scores and adherence to underwriting policies that emphasize conservative loan-to-value ratios of generally no more than 80%. To reduce interest rate risk, substantially all originations of fixed-rate loans to individuals for 1-4 family residential mortgages with maturities of 15 years or greater are sold in the secondary market. With the increase in mortgage rates since the middle of 2013 that continued to mid-2014, mortgage loan origination activity has slowed. There was $380,000 in residential mortgage loans held-for-sale at December 31, 2014 and no mortgages held-for sale at December 31, 2013. These loans are carried at the lower of aggregate cost or market.

The home equity portfolio consists of fixed-rate home equity loans and variable rate home equity lines of credit. These loans are often in a junior lien position and therefore carry a higher risk than first lien 1-4 family residential loans. Risks associated with loans secured by residential properties, either first lien residential mortgages or home equity loans and lines, are generally lower than commercial loans and include general economic risks, such as the strength of the job market, employment stability and the strength of the housing market. Since most loans are secured by a primary or secondary residence, the borrower's continued employment is the greatest risk to repayment.

The Company offers a variety of loans to individuals for personal and household purposes. Consumer loans are generally considered to have greater risk than loans secured by residential real estate because they may be unsecured, or, if they are secured, the value of the collateral may be difficult to assess or more likely to decrease in value than real estate. Credit risk in this portfolio is controlled by conservative underwriting standards that consider debt-to-income levels and the creditworthiness of the borrower, and, if secured, the value of the collateral.

Total loans, excluding loans held-for-sale, at December 31, 2014 were $555,282,000, an increase of $53,566,000, or 10.7%, from December 31, 2013. This follows a 5.0% increase in outstanding loans in 2013. A key financial ratio, loans to deposits, improved to 65.2% at December 31, 2014, compared with 61.6%, at December 31, 2013. QNB continues to be committed to make loans available to credit worthy consumers and businesses.

The Allowance for Loan Losses Allocation table shows the percentage composition of the loan portfolio over the past five years. There was very little change in the composition of the portfolio between the periods ended December 31, 2013 and 2014. Loans secured by commercial real estate represent the largest sector of the portfolio, decreasing from 38.0% of the portfolio at December 31, 2013 to 36.7% of the portfolio at December 31, 2014, while balances in this sector grew by $12,932,000, or 6.8%, from $190,602,000 at December 31, 2013 to $203,534,000 at December 31, 2014. While loans secured by commercial real estate represent a significant portion of the total portfolio, the collateral is diversified including investment properties, manufacturing facilities, office buildings, hospitals, retirement and nursing home facilities, warehouses and owner-occupied facilities. Commercial real estate loans have drawn the attention of the regulators in recent years as a potential source of risk. As a result, QNB has increased its monitoring of these types of loans including obtaining updated appraisals on loans classified substandard or worse. As detailed in the Allowance for Loan Losses table, QNB had $70,000 in charge-offs in this category in 2014 compared with $639,000 in 2013. A partial charge-off of a commercial loan secured by a commercial building contributed to this charge off; at December 31, 2014, the property was under an agreement of sale.

Commercial loans secured by residential real estate increased by $5,405,000, or 11.3%, to $53,077,000 at December 31, 2014 and at 9.6% represent a slightly larger share of the overall portfolio at December 31, 2014. These loans represented 9.5% of the portfolio at year-end 2013. As noted earlier this category includes 1-4 unit residential investment properties that the owner/borrower rents out to tenants. Some of these properties are located outside the Bank’s market area and have experienced vacancies and significant declines in market value. Charge-offs in this category have increased over the past three years. Non-accrual commercial loans secured by residential real estate were $1,467,000 and $2,829,000 at December 31, 2014 and 2013, respectively, and loan charge-offs were $1,069,000 and $401,000, respectively, in 2014 and 2013. All of the charge-offs in 2014 and 2013 in this category relate to these out of market investment properties. In response, QNB has adjusted its guidelines to originate these types of loans.

Commercial and industrial loans, the second largest sector of the portfolio, continues to experience growth increasing $7,506,000, or 6.7%, to $118,845,000 at December 31, 2014. This followed growth in this category of $11,276,000, or 11.3%, in 2013. Commercial and industrial loans represented 21.4% of the portfolio at year-end 2014 compared with 22.2% at December 31, 2013. As noted earlier this category of loans generally presents a greater risk than loans secured by real estate since these loans are either secured by accounts receivable, inventory or equipment, or unsecured. Losses in commercial and industrial loans were significant during the years 2010-2011 with charge-offs totaling $1,300,000. However, in 2014, 2013 and 2012 charge-offs were $17,000, $68,000, and $101,000, respectively and in 2014, recoveries in this segment were $67,000, exceeding the charge-offs.

Loan Portfolio

December 31,	**2014**	**2013**	**2012**	**2011**	**2010**
Commercial:					
Commercial and industrial	$118,845	$111,339	$100,063	$96,163	$86,628
Construction	23,471	15,929	11,061	15,959	18,611
Secured by commercial real estate	203,534	190,602	192,867	195,813	199,874
Secured by residential real estate	53,077	47,672	41,003	45,070	44,444
State and political subdivisions	44,104	33,773	34,256	35,127	31,053
Loans to depository institutions	-	1,250	3,250	4,515	-
Indirect lease financing	7,685	8,364	9,685	11,928	12,995
Retail:					
1-4 family residential mortgages	37,147	29,730	28,733	25,518	23,127
Home equity loans and lines	63,213	59,977	54,860	57,579	62,726
Consumer	4,175	3,116	2,012	2,308	2,751
Total loans	555,251	501,752	477,790	489,980	482,209
Net unearned costs (fees)	31	(36)	(57)	(44)	(27)
Loans receivable	$555,282	$501,716	$477,733	$489,936	$482,182

Loan Maturities and Interest Sensitivity

December 31, 2014	**One year or less**	**After one year through five years**	**After five years**	**Total**
Commercial:				
Commercial and industrial	$54,693	$36,232	$27,920	$118,845
Construction	8,249	813	14,409	23,471
Secured by commercial real estate	4,383	11,700	187,451	203,534
Secured by residential real estate	746	2,015	50,316	53,077
State and political subdivisions	45	6,317	37,742	44,104
Indirect lease financing	419	7,266	-	7,685
Retail:				
1-4 family residential mortgages	-	564	36,583	37,147
Home equity loans and lines	7,449	5,430	50,334	63,213
Consumer	728	1,655	1,792	4,175
Total	$76,712	$71,992	$406,547	$555,251

Demand loans and loans with no stated maturity are included in one year or less.

The following shows the amount of loans due after one year that have fixed interest rates and variable or adjustable interest rates at December 31, 2014:

Loans with fixed predetermined interest rates:	$86,552,000
Loans with variable or adjustable interest rates:	$391,987,000

Construction loans increased 47.3% from $15,929,000, or 3.2% of the portfolio at December 31, 2013, to $23,471,000, or 4.2% of the portfolio at December 31, 2014. These loans are primarily to developers and builders for the construction of residential units or commercial buildings or to businesses for the construction of owner-occupied facilities. This portfolio is diversified among different types of collateral including: 1-4 family residential construction, medical and retirement home facilities, office buildings, hotels and land for development loans. Construction loans are generally made only on projects that have municipal approval. These loans are usually originated to include a short construction period followed by permanent financing provided through a commercial mortgage after construction is complete. Once construction is complete the balance is moved to the secured by commercial real estate category if the permanent financing is provided by the Bank. The growth in the portfolio in 2014 is primarily related to the Bank's participation in a large project to improve downtown Allentown, Pennsylvania, which started in 2013, as well as construction loans for a number of business expansions in the Bank's market footprint. There were no charge-offs in the construction loan portfolio since 2011 and construction loans on non-accrual continue to improve declining from $1,319,000 a December 31, 2013 to $337,000 at December 31, 2014.

Loans to state and political subdivisions increased from $33,773,000 at December 31, 2013 to $44,104,000 at December 31, 2014, an increase of $10,331,000, or 30.6%. This sector grew from 6.7% of the total loan portfolio at December 31, 2013 to 7.9% at December 31, 2014. The strong growth in 2014 followed a decrease of $483,000, or 1.4%, between 2012 and 2013. With the significant decline in interest rates many municipalities, counties and school districts are refinancing their existing bonds or bank debt. As a result, QNB is getting an opportunity to bid on many of these local issues and has been successful in winning several of those bids. The refinancing activity has also resulted in a reduction in yield. QNB expects the balance in this category to increase in 2015 as some of the bids placed during 2014 may fund during the first quarter of 2015.

Indirect lease financing receivables experienced a fifth consecutive year of declining balances. Balances dropped $679,000 from $8,364,000 at December 31, 2013 to $7,685,000 at December 31, 2014. These lease financing receivables were purchased from two third party sources. This portfolio contains leases to government agencies and universities as well as to industries hit hard by the slowdown in the economy: trucking, landscaping and construction. As a result of a high level of charge-offs and delinquency in this portfolio in 2008 and 2009, QNB strengthened its underwriting standards with regard to this portfolio. This tightening of underwriting standards resulted in a reduction in net charge-offs and the balance of non-performing leases. QNB experienced net charge-offs of $25,000 in 2014 and a net recovery of $28,000 in 2013. Non-performing assets, including repossessed equipment and non-accrual lease financing receivables, were $21,000 and $37,000 as of December 31, 2014 and 2013, respectively. The tightening of underwriting standards, as well as the elimination of one of the third party sources, has also resulted in the purchase of fewer leases.

QNB desires to become the “local consumer lender of choice” and to affect this QNB has refocused its retail lending efforts by strengthening the management of the area, adding new product offerings and by increasing marketing and promotion. This renewed focus resulted in increased balances in home equity loans and lines of $3,236,000, or 5.4%, to $63,213,000 at December 31, 2014. During 2014, in an effort to increase demand, QNB offered very attractive rates on both variable and fixed rate home equity loans and lines. These promotional rates along with excellent customer service including quick turnaround time contributed to the growth in home equity balances. With an improvement in home values and improving local economy, it is expected that the demand for home equity loans will continue to improve.

Consumer loans is another category that benefited from the renewed focus with balances increasing $1,059,000, or 34.0%, to $4,175,000 at December 31, 2014. During the fourth quarter of 2013, QNB reentered the private student loan market through a relationship with iHelp. These student loans are either fixed or variable rate with the rate dependent on the credit scores of the student and/or the cosigner. Principal and interest protection is provided by ReliaMax, an insurance company for private student loans. As of December 31, 2014 the balance of student loans was $907,000. Also contributing to the increase in consumer loan balances was competitive pricing on automobile loans.

QNB increased the balances of residential mortgage loans secured by first lien 1-4 family residential mortgages by $7,417,000, or 24.9%, to $37,147,000 at December 31, 2014. This followed an increase of $997,000, or 3.5%, between December 31, 2012 and December 31, 2013. In 2014, QNB retained some adjustable rate mortgages to borrowers with high credit scores and low loan to value ratios.

Non-Performing Assets

Non-performing assets include non-performing loans, OREO and repossessed assets and non-performing trust preferred securities. Non-performing assets declined for the third consecutive year, totaling $18,152,000 or 1.86% of total assets at December 31, 2014. This is down $2,156,000 from $20,308,000, or 2.18% of total assets at December 31, 2013. Included in non-performing assets in 2014 and 2013 is $2,439,000 and $2,069,000, respectively, of pooled trust preferred securities, discussed in the section titled “Investment Securities and Other Short-Term Investments”. The increase in the amount of non-performing pooled trust preferred securities is a result of the increase in the fair value of these securities, not as a result of the classification of additional securities.

Total non-performing loans, which represent loans on non-accrual status, loans past due 90 days or more and still accruing interest and troubled debt restructured loans were $12,667,000 or 2.28% of total loans at December 31, 2014 compared with $15,413,000, or 3.07% of total loans at December 31, 2013. Loans on non-accrual status were $10,770,000 at December 31, 2014 compared with $13,453,000 at December 31, 2013. The reduction in non-accrual loans is the result of approximately $4,300,000 in payments and $1,100,000 in charge-offs which was partially offset by the designation of a large relationship as non-accrual in the fourth quarter 2014. In cases where there is a collateral shortfall on non-accrual loans, specific impairment reserves have been established based on updated collateral values even if the borrower continues to pay in accordance with the terms of the agreement. Of the total amount of non-accrual loans at December 31, 2014, $5,418,000, or 50.3% of the loans classified as non-accrual, are current or past due less than 30 days as of the end of the year.

QNB had no loans 90 days or more past due and still accruing at December 31, 2014, compared to $1,000 in loans past due 90 days or more and still accruing at December 31, 2013. Total loans that are 30 days or more past due increased $1,317,000 to $6,703,000, representing 1.21% of total loans at December 31, 2014 compared with 1.07% of total loans at December 31, 2013. Restructured loans, as defined in accounting guidance for troubled debt restructuring in ASC 310-40, that have not already been included in loans past due 90 days or more and still accruing or in non-accrual loans totaled $1,897,000 and $1,960,000 at December 31, 2014 and 2013, respectively.

OREO and repossessed assets are in the “Other Assets” category on the Consolidated Balance Sheets. OREO totaled $3,025,000 and $2,825,000 at December 31, 2014 and 2013, respectively. Included in OREO at December 31, 2014 is one commercial property with a fair value of $2,325,000 that was under agreement of sale and settled in January 2015, a participation in a construction project with a fair value of $500,000, as well as two residential properties. OREO at December 31, 2013 consisted of the same commercial property and construction participation in the December 31, 2014 balance. Repossessed assets, which includes equipment from the indirect leasing portfolio, totaled $21,000 at December 31, 2014. There were no repossessed assets as of December 31, 2013.

Non-Performing Assets December 31,	**2014**	**2013**	**2012**	**2011**	**2010**
Loans past due 90 days or more and accruing					
Commercial:					
Commercial and industrial	$ -	-	$ -	-	-
Construction	-	-	-	-	-
Secured by commercial real estate	-	-	-	$ 286	$ 259
Secured by residential real estate	-	-	-	-	-
State and political subdivisions	-	-	-	40	9
Loans to depository institutions	-	-	-	-	-
Indirect lease financing	-	-	-	54	-
Retail:	-	-	-		
1-4 family residential mortgages	-	-	-	-	-
Home equity loans and lines	-	-	-	-	-
Consumer	-	$ 1	-	-	-
Total loans past due 90 days or more and accruing	-	1	-	380	268
Non-accrual loans					
Commercial:					
Commercial and industrial	2,171	3,956	6,174	5,410	1,082
Construction	337	1,319	2,480	3,474	1,334
Secured by commercial real estate	6,465	4,630	6,748	7,547	3,837
Secured by residential real estate	1,467	2,829	2,390	1,158	97
State and political subdivisions	-	-	1	4	-
Loans to depository institutions	-	-	-	-	-
Indirect lease financing	-	37	98	121	255
Retail:					
1-4 family residential mortgages	225	401	335	515	433
Home equity loans and lines	104	265	346	368	145
Consumer	1	16	-	-	-
Total non-accrual loans	10,770	13,453	18,572	18,597	7,183
Restructured loans, not included above	1,897	1,960	2,578	2,413	2,421
Other real estate owned	3,025	2,825	1,151	826	75
Repossessed assets	21	-	10	-	15
Non-accrual pooled trust preferred securities	2,439	2,069	1,962	1,929	1,672
Total non-performing assets	$ 18,152	$ 20,308	$ 24,273	$ 24,145	$ 11,634
Total as a percent of total assets	1.86 %	2.18 %	2.64 %	2.78 %	1.44 %

Additional loan quality information can be found in Note 5 of the Notes to the Consolidated Financial Statements included in Item 8 of this Form 10-K. Management's view is that loans classified as substandard or doubtful that are not included in the past due, non-accrual or restructured categories are potential problem loans. For some of these loans management may have knowledge of possible credit problems that will cause management to question the ability of the borrowers to comply with the present loan repayment terms. In addition to the marked improvement in total non-performing loans, commercial loans classified as substandard or doubtful, which includes non-performing loans, continue to improve. At December 31, 2014 substandard or doubtful loans totaled $34,354,000, a reduction of $4,469,000 or 11.5%, from the $38,823,000 reported as of December 31, 2013.

Allowance for Loan Losses

The allowance for loan losses represents management's best estimate of the known and inherent losses in the existing loan portfolio. Management believes that it uses the best information available to make determinations about the adequacy of the allowance and that it has established its existing allowance for loan losses in accordance with U.S. generally accepted accounting principles (GAAP). The determination of an appropriate level of the allowance for loan losses is based upon an analysis of the risks inherent in QNB's loan portfolio. Management, in determining the allowance for loan losses makes significant estimates and assumptions. Since the allowance for loan losses is dependent, to a great extent, on conditions that may be beyond QNB's control, it is at least reasonably possible that management's estimates of the allowance for loan losses and actual results could differ. In addition, various regulatory agencies, as an integral part of their examination process, periodically review QNB's allowance for losses on loans. Such agencies may require QNB to recognize changes to the allowance based on their judgments about information available to them at the time of their examination. Actual loan losses, net of recoveries, serve to reduce the allowance.

Management closely monitors the quality of its loan portfolio and performs a quarterly analysis of the appropriateness of the allowance for loan losses and the level of unallocated reserves. This analysis considers a number of relevant factors including: specific impairment reserves, historical loan loss experience, general economic conditions, levels of and trends in delinquent and non-performing loans, levels of classified loans, trends in the growth rate of loans and concentrations of credit.

Economic conditions during the financial crisis and recession contributed to high rates of unemployment and a sharp decline in the residential and commercial real estate markets. These factors had a negative impact on both consumers and small businesses and contributed to higher than historical levels of net charge-offs, specific reserves and non-performing, impaired and classified loans. As a result higher provisions for loan losses were taken to bring the allowance for loan losses to adequate levels to support the decline in asset quality. Since December 31, 2008, the start of the financial crisis, QNB has increased its allowance for loan losses from $3,836,000, or 0.95% of total loans, to $8,001,000 or 1.44% of total loans at December 31, 2014. During 2014, economic conditions and asset quality have improved allowing for a reduction in the required allowance for loan losses. The allowance for loan losses was $8,925,000, or 1.78% of total loans at December 31, 2013.

Allowance for Loan Losses Allocation

December 31,	**2014**			**2013**			**2012**			**2011**			**2010**		
	Amount	**Percent gross loans**		**Amount**	**Percent gross loans**		**Amount**	**Percent gross loans**		**Amount**	**Percent gross loans**		**Amount**	**Percent gross loans**	
Balance at end of period applicable to:															
Commercial:															
Commercial and industrial	$1,892	21.4	%	$2,044	22.2	%	$2,505	20.9	%	$2,959	19.6	%	$2,136	18.0	%
Construction	297	4.2		439	3.2		209	2.3		556	3.3		633	3.9	
Secured by commercial real estate	2,700	36.7		2,898	38.0		3,795	40.4		3,124	40.0		3,875	41.4	
Secured by residential real estate	1,630	9.6		1,632	9.5		1,230	8.6		746	9.2		676	9.2	
State and political subdivisions	221	7.9		186	6.7		260	7.2		195	7.2		108	6.4	
Loans to depository institutions	-	-		4	0.2		15	0.7		20	0.9		-	0.0	
Indirect lease financing	93	1.4		103	1.7		168	2.0		312	2.4		496	2.7	
Retail:															

1-4 family residential mortgages	312	6.7	303	5.9	324	6.0	249	5.2	212	4.8
Home equity loans and lines	453	11.4	583	12.0	582	11.5	625	11.7	646	13.0
Consumer	85	0.7	64	0.6	27	0.4	20	0.5	32	0.6
Unallocated	318		669		657		435		141	
Total	$8,001	100.0 %	$8,925	100.0 %	$9,772	100.0 %	$9,241	100.0 %	$8,955	100.0 %

Gross loans represent loans before unamortized net loan fees and costs. Percent gross loans lists the percentage of each loan type to total loans.

A loan is considered impaired, based on current information and events, if it is probable that QNB 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 may not be classified as impaired. Management determines the significance of payment delays and shortfalls on a case-by-case basis, taking into consideration all the circumstances surrounding the loan and the borrower, including 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 loans and indirect lease financing 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. At December 31, 2014 and 2013, the recorded investment in loans for which impairment has been identified totaled $21,077,000 and $27,617,000, respectively, of which $19,019,000 and $22,515,000, respectively, required no specific allowance for loan loss. The recorded investment in impaired loans requiring an allowance for loan losses was $2,058,000 and $5,102,000 at December 31, 2014 and 2013, respectively. At December 31, 2014 and 2013 the related allowance for loan losses associated with these loans was $1,194,000 and $2,022,000, respectively. See Note 5 to the Notes to Consolidated Financial Statements included in Item 8 of this Form 10-K for additional detail of impaired loans.

Allowance for Loan Losses

	2014	2013	2012	2011	2010
Allowance for loan losses:					
Balance, January 1	$8,925	$9,772	$9,241	$8,955	$6,217
Charge-offs					
Commercial:					
Commercial and industrial	17	68	101	732	568
Construction	-	-	-	634	-
Secured by commercial real estate	70	639	85	941	278
Secured by residential real estate	1,069	401	111	54	113
State and political subdivisions	-	-	-	-	-
Loans to depository institutions	-	-	-	-	-
Indirect lease financing	39	2	85	43	254
Retail:					
1-4 family residential mortgages	95	-	21	-	-
Home equity loans and lines	156	234	114	77	60
Consumer	167	77	64	26	54
Total charge-offs	1,613	1,421	581	2,507	1,327
Recoveries					
Commercial:					
Commercial and industrial	67	28	76	22	13
Construction	-	-	-	-	-
Secured by commercial real estate	3	1	76	13	-
Secured by residential real estate	48	60	-	-	-
State and political subdivisions	-	1	-	-	-
Loans to depository institutions	-	-	-	-	-
Indirect lease financing	14	30	36	41	218
Retail:					
1-4 family residential mortgages	1	-	2	-	-
Home equity loans and lines	110	28	12	4	-
Consumer	46	26	10	13	34
Total recoveries	289	174	212	93	265
Net charge-offs	(1,324)	(1,247)	(369)	(2,414)	(1,062)
Provision for loan losses	400	400	900	2,700	3,800
Balance, December 31	$8,001	$8,925	$9,772	$9,241	$8,955
Total loans (excluding loans held-for-sale)					
Average	$523,825	$482,112	$480,068	$476,612	$466,524
Year-end	555,282	501,716	477,733	489,936	482,182
Ratios:					
Net charge-offs to:					
Average loans	0.25 %	0.26 %	0.08 %	0.51 %	0.23 %
Loans at year-end	0.24	0.25	0.08	0.49	0.22
Allowance for loan losses	16.55	13.97	3.78	26.13	11.86
Provision for loan losses	331.00	311.75	41.00	89.44	27.95

Allowance for loan losses to:										
Average loans	1.53	%	1.85	%	2.04	%	1.94	%	1.92	%
Loans at year-end	1.44		1.78		2.05		1.89		1.86	

QNB had net loan charge-offs of $1,324,000, or 0.25% of average loans for 2014 compared to $1,247,000, or 0.26% of average loans for 2013. One commercial real estate property, now under agreement of sale, was charged off in the amount of $70,000, management's estimate of the shortfall from sale proceeds and book balance. The leasing portfolio's charge-offs totaled $39,000 in 2014 and one commercial and industrial loan was charged off for $17,000. The majority of charge-offs recorded during 2014 had specific reserves established during the allowance for loan loss calculation process prior to the ultimate decision to charge-off the loan. Twenty-seven out of market residential investment property loans accounted for $1,069,000 of gross charge-offs of $1,613,000 in 2014. The remaining charge-offs totaling $418,000 are from the retail portfolio. For 2013, partial charge-offs of two commercial loans secured by owner occupied commercial buildings where the business ceased operations contributed $486,000 of the total charge-offs. Both of these properties were transferred to OREO with one sold in 2013 and the other sold in January 2015. In addition, thirteen out of market residential investment property loans accounted for another $401,000 of the charge-offs in 2013.

Management believes the allowance for loan losses of $8,001,000 is adequate as of December 31, 2014 in relation to the estimate of known and inherent losses in the portfolio.

Premises and equipment

Premises and equipment, net of depreciation decreased $173,000 to $9,702,000 at December 31, 2014.

Other assets

The category of other assets decreased $2,283,000 from $10,365,000 at December 31, 2013 to $8,082,000 at December 31, 2014. Most of the increase in other assets relates to the change in the deferred tax asset resulting from the change in fair value of the available-for-sale investment portfolio between December 31, 2013 and 2014. The net deferred tax asset was$2,925,000 at December 31, 2014, a decrease of $2,593,000 compared to $5,518,000 at December 31, 2013. The detail of the net deferred tax asset can be found in Note 11 in the Notes to Consolidated Financial Statements.

LIABILITIES

The following table presents total liabilities at the dates indicated:

Change from
prior year

Year ended December 31,	2014	2013	Amount	Percent
Deposits	$851,592	$814,532	$37,060	4.5 %
Short-term borrowings	35,189	35,156	33	0.1
Long-term debt	-	5,000	(5,000)	-100.0
Accrued interest payable	344	392	(48)	-12.2
Other liabilities	3,656	2,178	1,478	67.9
Total liabilities	$890,781	$857,258	$33,523	3.9 %

Deposits

QNB primarily attracts deposits from within its market area by offering various deposit products. These deposits are in the form of time deposits which include certificates of deposit and individual retirement accounts (IRA’s) which have a stated maturity and non-maturity deposit accounts which include: non-interest bearing demand accounts, interest-bearing demand accounts, money market accounts and savings accounts.

Total deposits increased $37,060,000, or 4.5%, to $851,592,000 at December 31, 2014. This follows an increase of $12,894,000, or 1.6%, between 2012 and 2013. The growth in deposits as well as the mix of deposits continues to be impacted by customers’ reactions to the industry, regulations and the interest rate environment. Given the low interest rate environment most customers are looking for transaction accounts that provide liquidity and pay a reasonable amount of interest. However, despite the decline in overall time deposit balances, those with maturities of 36 months through 60 months have increased due to some customers seeking a higher rate of interest and not being concerned about liquidity. Customers appear to be looking for the safety of FDIC insured deposits and the stability of a strong local community bank.

When comparing balances at December 31, 2014 to 2013, all categories increased. Similar to the past four years, the growth in 2014 was centered in lower-cost core deposits including interest-bearing demand and savings deposits, accounts with greater liquidity. This growth is consistent with customers seeking the highest rate for the shortest term and the liquidity of a non-maturity account especially in light of the slight rate differential between these deposits and time deposits The Bank currently offers several attractive non-maturity interest-bearing account options that pay very competitive rates and allow the flexibility to add and withdraw funds without penalty.

Contributing to the increase in total deposits was growth in non-interest bearing demand accounts which increased $10,933,000, or 14.4%, to $86,920,000 at December 31, 2014. This followed growth of $2,302,000, or 3.1%, between December 31, 2012 and December 31, 2013. These deposits are primarily comprised of business checking accounts and are volatile depending on the timing of deposits and withdrawals. Average non-interest bearing demand accounts increased $7,043,000, or 9.6%, to $80,427,000 when comparing 2014 to 2013. This compares to an increase of 9.3% in average balances when comparing 2013 to 2012. QNB has been successful in attracting new customers and expanding relationships with existing customers which not only contributes to the increase in balances but also provides an opportunity for fee income.

Interest-bearing demand accounts, retail and business interest checking and municipal accounts, increased $15,076,000, or 6.4%, to $251,986,000 at December 31, 2014. While all segments experienced growth in 2014, the majority of the growth was in retail checking, which also comprises the Rewards checking product and checking accounts for individuals over the age of 50, Select 50, which carry higher interest rates. Rewards checking balances increased from $34,969,000 at December 31, 2013 to $39,413,000 at December 31, 2014 and Select 50 balances increased from $53,822,000 to $59,627,000 over this same period. Personal interest-bearing balances also increased from $11,775,000 at December 31, 2013 to $12,908,000 at December 31, 2014. QNB continues to open a significant number of new checking accounts. Municipal deposits, which include school district and township deposits increased $2,324,000, or 1.9%, to $126,066,000 at December 31, 2014. During the past three years QNB has been successful in developing new relationships with several school districts and municipalities as well as expanding existing relationships with several others. The balances in these accounts are seasonal in nature and can be volatile on a daily basis. Most of the school district taxes are collected during the third quarter of the year and are disbursed over a nine month period. Average municipal deposits grew $16,226,000, or 15.6% for 2014. The total of all average interest-bearing demand accounts increased $25,474,000, or 11.9%, to $239,171,000 for 2014.

Total savings account balances increased $4,011,000, or 1.9%, to $211,240,000 at December 31, 2014. The increase in savings accounts is attributable to statement savings whose balances increased from $50,090,000 at December 31, 2013 to $54,682,000 at December 31, 2014. The balance of eSavings account, which was introduced in 2009 to compete with competitors' online savings products currently yields 0.46%, declined $575,000 to $156,265,000 at December 31, 2014. Rate reductions from 1.85% to 0.45% since the creation of this product in 2009 have contributed to a slowdown in the tremendous growth this product experienced after its introduction.

Total time deposit account balances were $243,247,000 at December 31, 2014, an increase of $3,702,000, or 1.5%, from the amount reported at December 31, 2013. This followed a decline of $29,689,000, or 11.0%, in 2013. As higher yielding time deposits matured during the past two years they were frequently reinvested in the high yielding and liquid Rewards or Select 50 checking, or eSavings account which in many instances paid a rate higher than what was offered on short-term time deposits. After the Fed announced that it would likely leave rates unchanged until 2015 and the yield curve flattened as a result, many customers began looking for the highest yield and opted for a 36- to 60-month time deposits. Balances in time deposits with these terms increased $18,696,000, or 16.3%, from $114,913,000 December 31, 2013 to $133,609,000 at December 31, 2014.

To continue to attract and retain deposits, QNB plans to be competitive with respect to rates and to continue to deliver products with terms and features that appeal to customers. The QNB Rewards checking and online eSavings accounts are examples of such products.

Maturity of Time Deposits of $100,000 or More

Year ended December 31,	**2014**	**2013**	**2012**
Three months or less	$9,599	$9,808	$13,028
Over three months through six months	9,043	8,983	19,477
Over six months through twelve months	24,207	17,350	21,774

Over twelve months	51,571	49,601	41,066
Total	$94,420	$85,742	$95,345

Average Deposits by Major Classification

	2014		2013		2012	
	Balance	**Rate**	**Balance**	**Rate**	**Balance**	**Rate**
Demand, non-interest bearing	$80,427	-	$73,384	-	$67,112	-
Interest-bearing demand	118,631	0.23%	109,383	0.24%	98,351	0.30%
Municipals interest-bearing demand	120,540	0.33	104,314	0.37	72,464	0.50
Money market	58,333	0.22	65,744	0.20	77,269	0.30
Savings	208,629	0.37	202,053	0.41	188,716	0.60
Time	151,002	1.08	162,837	1.16	180,293	1.33
Time of $100,000 or more	91,522	1.26	91,124	1.31	101,579	1.43
Total	$829,084	0.53%	$808,839	0.58%	$785,784	0.75%

Short-term borrowings and long-term debt

Short-term borrowings comprising commercial sweep accounts remained flat, growing $33,000 to $35,189,000 at December 31, 2014. In April 2014, QNB paid off a term repo borrowing from a correspondent bank of $5,000,000.

Liquidity

Liquidity represents an institution's ability to generate cash or otherwise obtain funds at reasonable rates to satisfy demand for loans and deposit withdrawals. QNB attempts to manage its mix of cash and interest-bearing balances, Federal funds sold and investment securities in an attempt to match the volatility, seasonality, interest sensitivity and growth trends of its loans and deposits. The Company manages its liquidity risk by measuring and monitoring its liquidity sources and estimated funding needs. Liquidity is provided from asset sources through repayments and maturities of loans and investment securities. The portfolio of investment securities classified as available for sale and QNB's policy of selling certain residential mortgage originations in the secondary market also provide sources of liquidity. Core deposits and cash management repurchase agreements have historically been the most significant funding source for QNB. These deposits and repurchase agreements are generated from a base of consumers, businesses and public funds primarily located in the Company's market area.

An additional source of liquidity is provided by the Bank's membership in the FHLB. At December 31, 2014, the Bank had a maximum borrowing capacity with the FHLB of approximately $227,142,000. The maximum borrowing capacity changes as a function of qualifying collateral assets. QNB had no outstanding borrowings with the FHLB at December 31, 2014 and 2013. In addition, the Bank maintains three unsecured Federal funds lines with three correspondent banks totaling $31,000,000. At December 31, 2014 and 2013, there were no outstanding borrowings under these lines. Future availability under these lines is subject to the policies of the granting banks and may be withdrawn. As part of its contingency funding plan, QNB successfully tested its ability to borrow from these sources during the fourth quarter of 2014.

Total cash and cash equivalents, trading and available-for-sale securities and loans held-for-sale totaled $398,051,000 at December 31, 2014 and $404,956,000 at December 31, 2013. The $6,905,000 decrease in liquid sources is primarily the result of a $9,244,000 decrease in trading plus available-for-sale securities which, along with the increase in deposits, helped fund the growth in loans in 2014. These liquid sources should be adequate to meet normal fluctuations in loan demand or deposit withdrawals. It is still anticipated that the investment portfolio will continue to provide sufficient liquidity as municipal bonds are called and as principal and interest payments on mortgage-backed and CMO securities provide steady cash flow. An increase in interest rates, however, would result in decreased cash flow available from the investment portfolio.

Approximately $206,774,000 and $207,868,000 of available-for-sale securities at December 31, 2014 and 2013, respectively, were pledged as collateral for repurchase agreements and deposits of public funds.

As an additional source of liquidity, QNB is a member of the Certificate of Deposit Account Registry Services (CDARS) program offered by the Promontory Interfinancial Network, LLC. CDARS is a funding and liquidity management tool used by banks to access funds and manage their balance sheet. It enables financial institutions to provide customers with full FDIC insurance on time deposits over $250,000 that are placed in the program. QNB also has available Insured Cash Sweep (ICS), another program through Promontory Interfinancial Network, LLC, which is a product similar to CDARS, but one that provides liquidity like a money market or savings account.

Other liabilities

The $1,478,000 increase in other liabilities in 2014 consists primarily of purchased, but not settled, marketable securities totaling $1,355,000. QNB purchased three municipal securities with trade dates in December 2014. The securities were funded and delivered in January 2015.

SHAREHOLDERS' EQUITY

The following table presents total shareholders' equity at the dates indicated:

			Change from prior year	
Year ended December 31,	**2014**	**2013**	**Amount**	**Percent**
Common stock	$2,176	$2,148	$28	1.3 %
Surplus	14,819	13,747	1,072	7.8
Retained earnings	70,928	65,618	5,310	8.1
Accumulated other comprehensive income (loss), net of tax	907	(3,412)	4,319	126.6
Treasury stock	(2,476)	(2,476)	-	-
Total shareholders' equity	$86,354	$75,625	$10,729	14.2 %

Total shareholders' equity increased $10,729,000, or 14.2%, to $86,354,000 at December 31, 2014 with retained earnings -- net income less dividends paid -- contributing $5,310,000 and the dividend reinvestment and stock purchase plan, employee stock purchase plan and stock option plan contributing $988,000. Accumulated other comprehensive income increased $4,319,000 resulting from the increase in fair value of the available-for-sale investment portfolio caused by decreasing interest rates in 2014. QNB remains "well capitalized" based on FDIC requirements.

Capital Adequacy

A strong capital position is fundamental to support continued growth and profitability and to serve the needs of depositors. QNB's shareholders' equity at December 31, 2014 was $86,354,000, or 8.84% of total assets, compared to shareholders' equity of $75,625,000, or 8.11% of total assets, at December 31, 2013. Shareholders' equity at December 31, 2014 included a positive adjustment of $907,000 related to unrealized holding gains, net of taxes, on investment securities available for sale while shareholders' equity at December 31, 2013 included a negative adjustment of $3,412,000, related to unrealized holding losses, net of taxes, on investment securities available-for-sale. Excluding these adjustments, shareholders' equity to total assets would have been 8.75% and 8.44% at December 31, 2014 and 2013, respectively.

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Average shareholders’ equity and average total assets were $82,623,000 and $947,864,000 for 2014, an increase of 7.8% and 2.7%, respectively, from 2013 average equity and average total assets of $76,663,000 and $923,188,000, respectively. The ratio of average total equity to total average assets was 8.72% for 2014, compared to 8.30% for 2013.

QNB is subject to restrictions on the payment of dividends to its shareholders pursuant to the Pennsylvania Business Corporation Law as amended (the BCL). The BCL operates generally to preclude dividend payments, if the effect thereof would render QNB insolvent, as defined. As a practical matter, QNB’s payment of dividends is contingent upon its ability to obtain funding in the form of dividends from the Bank. Under Pennsylvania banking law, the Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. At December 31, 2014, $76,232,000 of retained earnings was available for dividends without prior regulatory approval, subject to the regulatory capital requirements discussed below. QNB paid dividends to its shareholders of $1.12 per share and $1.08 per share in 2014 and 2013, respectively.

QNB is subject to various regulatory capital requirements as issued by Federal regulatory authorities. Regulatory capital is defined in terms of Tier 1 capital (shareholders’ equity excluding unrealized gains or losses on available-for-sale securities and disallowed intangible assets), Tier 2 capital which includes the allowable portion of the allowance for loan losses which is limited to 1.25% of risk-weighted assets and a portion of the unrealized gains on equity securities, and total capital (Tier 1 plus Tier 2). Risk-based capital ratios are expressed as a percentage of risk-weighted assets. Risk-weighted assets are determined by assigning various weights to all assets and off-balance sheet arrangements, such as letters of credit and loan commitments, based on associated risk. Regulators have also adopted minimum Tier 1 leverage ratio standards, which measure the ratio of Tier I capital to total quarterly average assets.

The minimum regulatory capital ratios are 4.00% for Tier 1 capital, 8.00% for total risk-based capital and 4.00% for leverage. Under the requirements, at December 31, 2014 and 2013, QNB has a Tier 1 capital ratio of 12.79% and 12.68%, a total risk-based ratio of 14.06% and 14.01%, and a leverage ratio of 8.65% and 8.45%, respectively. All regulatory capital ratios have improved from December 31, 2013 as the growth rate of Tier I and total capital has exceeded the growth rate of risk-weighted and average assets.

Continuing to impact risk-weighted assets is the $26,451,000 of risk-weighted assets due to mezzanine tranches of pooled trust preferred securities that were downgraded below investment grade during the first quarter of 2009. Although the amortized cost of these securities was only $3,519,000 at December 31, 2014, regulatory guidance required an additional $22,932,000 to be included in risk-weighted assets. The Bank utilized the method as outlined in the Call Report Instructions for an available-for-sale bond that has not triggered the Low Level Exposure (LLE) rule. The mezzanine tranches of CDOs that utilized this method of risk-weighting are five out of six pooled trust preferred securities (PreTSLs) held by the Bank as of December 31, 2014. The other pooled trust preferred security has only one tranche remaining so the treatment noted above does not apply.

QNB offers a Dividend Reinvestment and Stock Purchase Plan (the "Plan") to provide participants a convenient and economical method for investing cash dividends paid on the Company's common stock in additional shares at a discount. The Plan also allows participants to make additional cash purchases of stock at a discount. Stock purchases under the Plan contributed $749,000 and $823,000 to capital during 2014 and 2013, respectively.

The Board of Directors has authorized the repurchase of up to 100,000 shares of QNB's common stock in open market or privately negotiated transactions. The repurchase authorization does not bear a termination date. As of December 31, 2014 and 2013, 57,883 shares were repurchased under this authorization at an average price of $16.97 and a total cost of $982,000. There were no shares repurchased under the plan since the first quarter of 2009.

The Federal Deposit Insurance Corporation Improvement Act of 1991 established five capital level designations ranging from "well capitalized" to "critically undercapitalized." At December 31, 2014 and 2013, management believes that the Company and the Bank met all capital adequacy requirements to which they are subject and have met the "well-capitalized" criterion which requires minimum Tier I and total risk-based capital ratios of 6.00% and 10.00%, respectively, and a leverage ratio of 5.00%.

In July 2013, the Federal bank regulatory agencies adopted final rules that revise the agencies' capital adequacy guidelines and prompt corrective action rules. These final rules were designed to enhance such requirements and implement the revised standards of the Basel Committee on Banking Supervision, commonly referred to as Basel III. The final rules generally implement higher minimum capital requirements, add a new common equity tier 1 capital requirement, and establish criteria that instruments must meet to be considered common equity Tier 1 capital, additional Tier 1 capital or Tier 2 capital. The new minimum capital to risk-adjusted assets requirements are a common equity Tier 1 capital ratio of 4.5% (6.5% to be considered "well capitalized") and a Tier 1 capital ratio of 6.0%, increased from 4.0% (and increased from 6.0% to 8.0% to be considered "well capitalized"); the total capital ratio remains at 8.0% under the new rules (10.0% to be considered "well capitalized"). Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity Tier 1 capital above its minimum risk-based capital requirements in an amount greater than 2.5% of total risk-weighted assets. The new minimum capital requirements are effective on January 1, 2015. The capital conservation buffer requirements phase in over a three-year period beginning January 1, 2016.

QNB will continue to analyze these new rules and their effects on the business, operations and capital levels of the Company and the Bank. The following table summarizes QNB's and the Bank's regulatory capital position at December 31, 2014 and December 31, 2013.

Capital Analysis

December 31,	**2014**	**2013**
Tier 1		
Shareholders' equity	$86,354	$75,625
Net unrealized securities (gains) losses, net of tax	(907)	3,412
Disallowed goodwill and other disallowed intangible assets	(8)	-
Total Tier I risk-based capital	85,439	79,037
Tier 2		
Allowable portion: Allowance for loan losses and reserve for unfunded commitments	8,060	7,806
Unrealized gains on equity securities, net of tax	428	487
Total risk-based capital	$93,927	$87,330
Risk-weighted assets	$667,818	$623,389
Quarterly average assets for leverage capital purposes	$987,527	$935,477

Capital Ratios

December 31,	**2014**	**2013**
Tier 1 capital/risk-weighted assets	12.79%	12.68%
Total risk-based capital/risk-weighted assets	14.06%	14.01%
Tier 1 capital/average assets (leverage ratio)	8.65 %	8.45 %

Recently Issued Accounting Standards

Refer to Note 1 of the Notes to Consolidated Financial Statements for discussion of recently issued accounting standards.

Critical Accounting Policies and Estimates

Disclosure of the Company's significant accounting policies is included in Note 1 to Consolidated Financial Statements. Additional information is contained in Management's Discussion and Analysis and the Notes to Consolidated Financial Statements for the most sensitive of these issues. The discussion and analysis of the financial condition and results of operations are based on the consolidated financial statements of QNB, which are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") and predominant practices within the banking industry. The preparation of these consolidated financial statements requires QNB to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. QNB evaluates estimates on an on-going basis, including those related to the determination of the allowance for loan losses, the determination of the valuation of other real estate owned, other-than-temporary impairments on investment securities, the determination of impairment of restricted bank stock, the valuation of deferred tax assets, stock-based compensation and income taxes. QNB bases its estimates on historical experience and various other factors and assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Other-than-Temporary Investment Security Impairment

Securities are evaluated periodically to determine whether a decline in their value is other-than-temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other-than-temporary. The term “other-than-temporary” is not intended to indicate that the decline is permanent, but indicates that the prospect for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. For equity securities, once a decline in value is determined to be other-than-temporary, the value of the equity security is reduced and a corresponding charge to earnings is recognized.

The Company follows the accounting guidance in Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 320-10 as it relates to the recognition and presentation of other-than-temporary impairment (“OTTI”). This accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held to maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the non-credit portion of a previous other-than-temporary impairment should be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

Allowance for Loan Losses

QNB considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than its other significant accounting policies. The allowance for loan losses is calculated with the objective of maintaining a level believed by management to be sufficient to absorb probable known and inherent losses in the outstanding loan portfolio. The allowance is reduced by actual credit losses and is increased by the provision for loan losses and recoveries of previous losses. The provisions for loan losses are charged to earnings to bring the total allowance for loan losses to a level considered necessary by management.

The allowance for loan losses is based on management's continual review and evaluation of the loan portfolio. The level of the allowance is determined by assigning specific reserves to individually identified problem credits and general reserves to all other loans. The portion of the allowance that is allocated to impaired loans is determined by estimating the inherent loss on each credit after giving consideration to the value of underlying collateral. The general reserves are based on the composition and risk characteristics of the loan portfolio, including the nature of the loan portfolio, credit concentration trends, delinquency and loss experience, as well as other qualitative factors such as current economic trends.

Management emphasizes loan quality and close monitoring of potential problem credits. Credit risk identification and review processes are utilized in order to assess and monitor the degree of risk in the loan portfolio. QNB's lending and credit administration staff are charged with reviewing the loan portfolio and identifying changes in the economy or in a borrower's circumstances which may affect the ability to repay debt or the value of pledged collateral. A loan classification and review system exists that identifies those loans with a higher than normal risk of collection. Each commercial loan is assigned a grade based upon an assessment of the borrower's financial capacity to service the debt and the presence and value of collateral for the loan. An independent loan review group tests risk assessments and evaluates the adequacy of the allowance for loan losses. Management meets monthly to review the credit quality of the loan portfolio and quarterly to review the allowance for loan losses.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review QNB's allowance for loan losses. Such agencies may require QNB to recognize additions to the allowance based on their judgments about information available to them at the time of their examination. Management believes that it uses the best information available to make determinations about the adequacy of the allowance and that it has established its existing allowance for loan losses in accordance with GAAP. If circumstances differ substantially from the assumptions used in making determinations, future adjustments to the allowance for loan losses may be necessary and results of operations could be affected. Because future events affecting borrowers and collateral cannot be predicted with certainty, increases to the allowance may be necessary should the quality of any loans deteriorate as a result of the factors discussed above.

Foreclosed Assets

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

Stock-Based Compensation

At December 31, 2014, QNB sponsored stock-based compensation plans, administered by a Board committee, under which both qualified and nonqualified stock options may be granted periodically to certain employees. QNB accounts for all awards granted under stock-based compensation plans in accordance with ASC 718, *Compensation – Stock Compensation*. Compensation cost has been measured using the fair value of an award on the grant date and is recognized over the service period, which is usually the vesting period. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date. QNB estimates the fair value of stock options on the date of the grant using the Black-Scholes option pricing model. The model requires the use of numerous assumptions, many of which are highly subjective in nature.

Income Taxes

QNB accounts for income taxes under the asset/liability method in accordance with income tax accounting guidance, ASC 740 – Income Taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established against deferred tax assets when, in the judgment of management, it is more likely than not that such deferred tax assets will not become available. Because the judgment about the level of future taxable income is dependent to a great extent on matters that may, at least in part, be beyond QNB's control, it is at least reasonably possible that management's judgment about the need for a valuation allowance for deferred taxes could change in the near term.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable to Company for fiscal year ended December 31, 2014.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following audited financial statements are set forth in this Annual Report on Form 10-K on the following pages:

Management's Report on Internal Control over Financial Reporting

March 13, 2015

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2014, in relation to criteria for effective internal control over financial reporting as described in "Internal Control Integrated Framework (1992)," issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") which was subsequently updated in 2013. Based on this assessment, management concludes that, as of December 31, 2014, the Company's system of internal control over financial reporting is effective and meets the criteria of the "Internal Control Integrated Framework (1992)."

Baker Tilly Virchow Krause, LLP, an independent registered public accounting firm, has audited the Company's consolidated financial statements as of and for the year ended December 31, 2014 and the effectiveness of the Company's internal control over financial reporting as of December 31, 2014, as stated in their reports, which are included herein.

/s/ David W. Freeman	/s/ Janice McCracken Erkes
David W. Freeman	Janice McCracken Erkes
Chief Executive Officer	Chief Financial Officer

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders

QNB Corp.

We have audited QNB Corp. and subsidiary's (the Company) internal control over financial reporting as of December 31, 2014, based on *criteria established in Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on the entity's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and directors of the entity; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on *criteria established in Internal Control—Integrated Framework (1992)* issued COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income (loss), shareholders' equity, and cash flows for the years then ended, and our report dated March 13, 2015 expressed an unqualified opinion on those consolidated financial statements.

/s/ Baker Tilly Virchow Krause, LLP

Allentown, Pennsylvania

March 13, 2015

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders

QNB Corp.

We have audited the accompanying balance sheets of QNB Corp. and subsidiary as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income (loss), shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of QNB Corp. and subsidiary as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), QNB Corp. and subsidiary's internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 13, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Baker Tilly Virchow Krause, LLP

Allentown, Pennsylvania

March 13, 2015

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

December 31,	2014	2013
Assets		
Cash and due from banks	$11,102	$12,717
Interest-bearing deposits in banks	7,143	3,569
Total cash and cash equivalents	18,245	16,286
Investment securities		
Trading	4,207	-
Available-for-sale (amortized cost $373,844 and $393,840)	375,219	388,670
Held-to-maturity (fair value $156 and $162)	146	146
Restricted investment in bank stocks	647	1,764
Loans held-for-sale	380	-
Loans receivable	555,282	501,716
Allowance for loan losses	(8,001)	(8,925)
Net loans	547,281	492,791
Bank-owned life insurance	10,658	10,407
Premises and equipment, net	9,702	9,875
Accrued interest receivable	2,568	2,579
Other assets	8,082	10,365
Total assets	$977,135	$932,883
Liabilities		
Deposits		
Demand, non-interest bearing	$86,920	$75,987
Interest-bearing demand	251,986	236,910
Money market	58,199	54,861
Savings	211,240	207,229
Time	148,827	153,803
Time of $100,000 or more	94,420	85,742
Total deposits	851,592	814,532
Short-term borrowings	35,189	35,156
Long-term debt	-	5,000
Accrued interest payable	344	392
Other liabilities	3,656	2,178
Total liabilities	890,781	857,258
Shareholders' Equity		
Common stock, par value $0.625 per share; authorized 10,000,000 shares; 3,481,227 shares and 3,436,227 shares issued; 3,316,658 and 3,271,658 shares outstanding	2,176	2,148
Surplus	14,819	13,747
Retained earnings	70,928	65,618
Accumulated other comprehensive income (loss), net of tax	907	(3,412)
Treasury stock, at cost; 164,569 shares	(2,476)	(2,476)

Total shareholders' equity	86,354	75,625
Total liabilities and shareholders' equity	$977,135	$932,883

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)		
Year ended December 31,	**2014**	**2013**
Interest Income		
Interest and fees on loans	$22,759	$22,245
Interest and dividends on investment securities:		
Taxable	5,406	5,611
Tax-exempt	2,223	2,682
Interest on trading securities	158	-
Interest on interest-bearing balances and other interest income	124	46
Total interest income	30,670	30,584
Interest Expense		
Interest on deposits		
Interest-bearing demand	673	649
Money market	126	133
Savings	770	820
Time	1,636	1,882
Time of $100,000 or more	1,155	1,189
Interest on short-term borrowings	114	111
Interest on long-term debt	70	249
Total interest expense	4,544	5,033
Net interest income	26,126	25,551
Provision for loan losses	400	400
Net interest income after provision for loan losses	25,726	25,151
Non-Interest Income		
Total other-than-temporary impairment loss on investment securities	-	(43)
Less: Portion of loss recognized in other comprehensive income (before taxes)	-	-
Net other-than temporary impairment losses on investment securities	-	(43)
Net gain on sale of investment securities	1,112	867
Net gain on investment securities	1,112	824
Net gain on trading activities	156	-
Fees for services to customers	1,687	1,594
ATM and debit card	1,485	1,499
Retail brokerage and advisory	657	523
Bank-owned life insurance	472	320
Merchant	299	367
Net gain on sale of loans	258	425
Gain on sale of internet domain name	1,000	-
Other	416	261
Total non-interest income	7,542	5,813
Non-Interest Expense		
Salaries and employee benefits	11,649	10,553
Net occupancy	1,705	1,638
Furniture and equipment	1,753	1,714
Marketing	841	971

Third party services	1,677	1,488
Telephone, postage and supplies	730	670
State taxes	617	690
FDIC insurance premiums	686	705
Other	1,968	1,797
Total non-interest expense	21,626	20,226
Income before income taxes	11,642	10,738
Provision for income taxes	2,644	2,346
Net Income	$8,998	$8,392
Earnings Per Share - Basic	$2.73	$2.58
Earnings Per Share - Diluted	$2.72	$2.57

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	(in thousands)					
Year ended December 31,	**2014**			**2013**		
	Before tax amount	**Tax expense (benefit)**	**Net of tax amount**	**Before tax amount**	**Tax expense (benefit)**	**Net of tax amount**
Net income	$11,642	$ 2,644	$8,998	$10,738	$2,346	$8,392
Other comprehensive income:						
Net unrealized holding gains (losses) on securities:						
Unrealized holding gains (losses) arising during the period	7,657	2,604	5,053	(11,098)	(3,774)	(7,324)
Reclassification adjustment for gains included in net income	(1,112)	(378)	(734)	(824)	(280)	(544)
Other comprehensive income (loss)	6,545	2,226	4,319	(11,922)	(4,054)	(7,868)
Total comprehensive income (loss)	$18,187	$ 4,870	$13,317	$(1,184)	$(1,708)	$524

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(in thousands, except share and per share data)	Number of shares outstanding	Common stock	Surplus	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total
Balance, December 31, 2012	3,228,003	$ 2,121	$ 12,787	$ 60,735	$ 4,456	$ (2,476)	$ 77,623
Net income	-	-	-	8,392	-	-	8,392
Other comprehensive loss, net of tax	-	-	-	-	(7,868)	-	(7,868)
Cash dividends declared ($1.08 per share)	-	-	-	(3,509)	-	-	(3,509)
Stock issued in connection with dividend reinvestment and stock purchase plan	35,481	22	801	-	-	-	823
Stock issued for employee stock purchase plan	3,692	2	77	-	-	-	79
Stock issued for options exercised	4,482	3	9	-	-	-	12
Tax benefit of stock options exercised	-	-	2	-	-	-	2
Stock-based compensation expense	-	-	71	-	-	-	71
Balance, December 31, 2013	3,271,658	$ 2,148	$ 13,747	$ 65,618	$ (3,412)	$ (2,476)	$ 75,625
Net income	-	-	-	8,998	-	-	8,998
Other comprehensive income, net of tax	-	-	-	-	4,319	-	4,319
Cash dividends declared ($1.12 per share)	-	-	-	(3,688)	-	-	(3,688)
Stock issued in connection with dividend reinvestment and stock purchase plan	29,288	18	731	-	-	-	749
Stock issued for employee stock purchase plan	3,239	2	72	-	-	-	74
Stock issued for options exercised	12,473	8	157	-	-	-	165
Tax benefit of stock options exercised	-	-	29	-	-	-	29
Stock-based compensation expense	-	-	83	-	-	-	83
Balance, December 31, 2014	3,316,658	$ 2,176	$ 14,819	$ 70,928	$ 907	$ (2,476)	$ 86,354

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	(in thousands)	
Year ended December 31,	**2014**	**2013**
Operating Activities		
Net income	$8,998	$8,392
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,167	1,146
Provision for loan losses	400	400
Net gains on investment securities available-for-sale	(1,112)	(824)
Net loss on sale of repossessed assets, other real estate owned and premises and equipment	2	179
Net gain on sale of loans	(258)	(425)
Gain on sale of internet domain name	(1,000)	-
Proceeds from sales of residential mortgages held-for-sale	6,589	17,022
Origination of residential mortgages held-for-sale	(6,711)	(14,981)
Income on bank-owned life insurance	(472)	(320)
Stock-based compensation expense	83	71
Net increase in trading securities	(4,207)	-
Deferred income tax expense	368	212
Net (decrease) increase in income taxes payable	(65)	35
Net decrease in accrued interest receivable	11	224
Amortization of mortgage servicing rights and change in valuation allowance	62	55
Net amortization of premiums and discounts on investment securities	2,148	2,265
Net decrease in accrued interest payable	(48)	(95)
(Increase) decrease in other assets	(100)	4,140
Increase (decrease) in other liabilities	122	(173)
Net cash provided by operating activities	5,977	17,323
Investing Activities		
Proceeds from payments, maturities and calls of investment securities available-for-sale	82,360	110,123
Proceeds from the sale of investment securities available-for-sale	29,972	19,559
Purchases of investment securities available-for-sale	(92,017)	(130,213)
Proceeds from redemption of investment in restricted bank stock	3,673	656
Purchase of restricted bank stock	(2,556)	(176)
Net increase in loans	(55,263)	(28,751)
Net purchases of premises and equipment	(995)	(2,048)
Proceeds from sale of internet domain name	1,000	-
Redemption of bank-owned life insurance	234	-
Proceeds from sales of repossessed assets	152	1,678
Net cash used by investing activities	(33,440)	(29,172)
Financing Activities		
Net increase in non-interest bearing deposits	10,933	2,302
Net increase in interest-bearing deposits	26,127	10,592
Net increase in short-term borrowings	33	2,668
Repayments of long-term debt	(5,000)	(287)
Tax benefit from exercise of stock options	29	2
Cash dividends paid, net of reinvestment	(3,328)	(3,130)

Proceeds from issuance of common stock	628	535
Net cash provided by financing activities	29,422	12,682
Increase in cash and cash equivalents	1,959	833
Cash and cash equivalents at beginning of year	16,286	15,453
Cash and cash equivalents at end of year	$18,245	$16,286
Supplemental Cash Flow Disclosures		
Interest paid	$4,592	$5,128
Income taxes paid	2,310	2,095
Non-cash transactions		
Transfer of loans to repossessed assets or other real estate owned	373	3,521
Unsettled trades to purchase securities	1,355	-

The accompanying notes are an integral part of the consolidated financial statements.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies

Business

QNB Corp. (the “Company”), through its wholly-owned subsidiary, QNB Bank (the “Bank”), has been serving the residents and businesses of Bucks, Lehigh, and Montgomery counties in Pennsylvania since 1877. The Bank is a locally managed community bank that provides a full range of commercial, retail banking and retail brokerage services. The Bank encounters vigorous competition for market share in the communities it serves from bank holding companies, other community banks, thrift institutions, credit unions and other non-bank financial organizations such as mutual fund companies, insurance companies and brokerage companies. The Company manages its business as a single operating segment.

The Bank is a Pennsylvania chartered commercial bank. The Company and the Bank are subject to regulations of certain state and Federal agencies. These regulatory agencies periodically examine the Company and the Bank for adherence to laws and regulations.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, the Bank. The consolidated entity is referred to herein as “QNB”. All significant inter-company accounts and transactions have been eliminated in the consolidated financial statements.

For comparative purposes, prior year’s consolidated financial statements have been reclassified to conform to the report classifications of the current year. The reclassifications had no effect on net income.

Tabular information, other than share and per share data, is presented in thousands of dollars.

Use of Estimates

These statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP") and predominant practices within the banking industry. The preparation of these consolidated financial statements requires QNB to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. QNB evaluates estimates on an on-going basis. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the determination of the valuation of other real estate owned, the fair value of financial instruments, other-than-temporary impairment of investment securities, the determination of impairment of restricted bank stock and the valuation of deferred tax assets and income taxes. QNB bases its estimates on historical experience and various other factors and assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Significant Group Concentrations of Credit Risk

Most of the Company's activities are with customers located within Bucks, Montgomery and Lehigh Counties in southeastern Pennsylvania. Note 4 discusses the types of investment securities in which the Company invests. Note 5 discusses the types of lending in which the Company engages. The Company does not have any significant concentrations to any one industry or customer. Although the Company has a diversified loan portfolio, its debtors' ability to honor their contracts is influenced by the region's economy.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents consist of cash on hand, cash items in process of collection, amounts due from banks, interest-bearing deposits in the Federal Reserve Bank and other banks and Federal funds sold. QNB maintains a portion of its interest-bearing deposits at various commercial financial institutions. At times, the balances exceed the FDIC insured limits.

Trading Securities

The Company engages in trading activities for its own account. Interest and dividends are included in interest income. Debt and equity securities that are bought and held principally for the purpose of selling in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings. In 2014, QNB sold approximately $5,000,000 in available-for-sale municipal securities and established a trading account with a broker with a balance of $4,207,000 at December 31, 2014, consisting of municipal securities and a brokerage cash account of $1,160,000. QNB had no trading securities at December 31, 2013.

Investment Securities

Investment securities that QNB has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost. Interest and dividends are included in interest income. Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses, net of tax, excluded from earnings and reported in other comprehensive income or loss, a separate component of shareholders' equity. Management determines the appropriate classification of securities at the time of purchase.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (continued)

Investment Securities (continued)

Available-for-sale securities include securities that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in credit ratings, changes in market interest rates and related changes in the securities' prepayment risk or to meet liquidity needs.

Premiums and discounts on debt securities are recognized in interest income using a constant yield method. Gains and losses on sales of available-for-sale securities are recorded on the trade date and are computed on the specific identification method and included in non-interest income.

Other-than-Temporary Impairment of Investment Securities

Securities are evaluated periodically to determine whether a decline in their value is other-than-temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other-than-temporary. The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support realizable value equal to or greater than carrying value of the investment. For equity securities, once a decline in value is determined to be other-than-temporary, the value of the equity security is reduced to fair value and a corresponding charge to earnings is recognized.

The Company follows the accounting guidance in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 320-10 as it relates to the recognition and presentation of other-than-temporary impairment ("OTTI"). This accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not, the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. For held to maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive income for the non-credit portion of a previous other-than-temporary impairment would be amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

Restricted Investment in Bank Stock

Restricted bank stock is comprised of restricted stock of the Federal Home Loan Bank of Pittsburgh ("FHLB") in the amount of $635,000 and the Atlantic Community Bankers Bank in the amount of $12,000 at December 31, 2014. Federal law requires a member institution of the FHLB to hold stock of its district bank according to a predetermined formula. These restricted securities are carried at cost.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the principal amount outstanding, net of deferred loan fees and costs. Interest income is accrued on the principal amount outstanding. Loan origination and commitment fees and related direct costs are deferred and amortized to income over the term of the respective loan and loan commitment period as a yield adjustment.

Loans held-for-sale consist of residential mortgage loans and are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recognized through a valuation allowance charged to income. Gains and losses on residential mortgages held-for-sale are included in non-interest income.

Non-Performing Assets

Non-performing assets are comprised of accruing loans past due 90 days or more, non-accrual loans and investment securities, restructured loans, other real estate owned and repossessed assets. Non-accrual loans and investment securities are those on which the accrual of interest has ceased. Loans and indirect lease financing loans are placed on non-accrual status immediately if, in the opinion of management, collection is doubtful, or when principal or interest is past due 90 days or more and collateral is insufficient to cover principal and interest. Interest accrued, but not collected at the date a loan is placed on non-accrual status, is reversed and charged against interest income. Subsequent cash receipts are applied either to the outstanding principal or recorded as interest income, depending on management's assessment of the ultimate collectability of principal and interest. Loans are returned to an accrual status when the borrower's ability to make periodic principal and interest payments has returned to normal (i.e. brought current with respect to principal or interest or restructured) and the paying capacity of the borrower and/or the underlying collateral is deemed sufficient to cover principal and interest.

From time to time, QNB may extend, restructure, or otherwise modify the terms of existing loans, on a case-by-case basis, to remain competitive and retain certain customers, as well as assist other customers that may be experiencing financial difficulties. A loan is considered to be a troubled debt restructuring ("TDR") loan when the Company grants a concession to the borrower because of the borrower’s financial condition that it would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of principal or interest, or other modifications of interest rates to less than the current market rate for new obligations with similar risk. Loans classified as TDRs are considered non-performing and are also designated as impaired.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (continued)

Non-Performing Assets (continued)

Accounting for impairment in the performance of a loan is required when it is probable that all amounts, including both principal and interest, will not be collected in accordance with the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, at the loan's observable market price or the fair value of the collateral if the loans are collateral dependent. Impairment criteria are applied to the loan portfolio exclusive of smaller homogeneous loans such as residential mortgage and consumer loans which are evaluated collectively for impairment.

Loans are fully charged-off or charged down to net realizable value (fair value of collateral less estimated costs to sell) when deemed uncollectible due to bankruptcy or other factors, or when they reach a defined number of days past due based on loan product, industry practice, terms and other factors.

Loans are considered past due when contractually required principal or interest payments have not been made on the due dates.

Allowance for Loan Losses

QNB maintains an allowance for loan losses, which is intended to absorb probable known and inherent losses in the outstanding loan portfolio. The allowance is reduced by actual credit losses and is increased by the provision for loan losses and recoveries of previous losses. The provisions for loan losses are charged to earnings to bring the total allowance for loan losses to a level considered necessary by management.

The allowance for loan losses is based on management's continuing review and evaluation of the loan portfolio. The level of the allowance is determined by assigning specific reserves to individually identified problem credits and general reserves to all other loans. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan. The portion of the allowance that is allocated to internally criticized and non-accrual loans is determined by estimating the inherent loss on each credit after giving consideration to the value of underlying collateral. 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 historical loss rates. These loss rates are based on a three year history of charge-offs and are more heavily weighted for recent experience for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

- Lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices.
- External factor effects, such as legal and regulatory requirements.
- 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.
- Nature and volume of the portfolio including growth.
- Experience, ability, and depth of lending management and staff.
- Volume and severity of past due, classified and nonaccrual loans.
- Quality of the Company’s loan review system, and the degree of oversight by the Company’s Board of Directors.
- Existence and effect of any concentrations of credit and changes in the level of such concentrations.

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.

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.

Management emphasizes loan quality and close monitoring of potential problem credits. Credit risk identification and review processes are utilized in order to assess and monitor the degree of risk in the loan portfolio. QNB’s lending and credit administration staff are charged with reviewing the loan portfolio and identifying changes in the economy or in a borrower’s circumstances which may affect the ability to repay debt or the value of pledged collateral. A loan classification and review system exists that identifies those loans with a higher than normal risk of collection. Each commercial loan is assigned a grade based upon an assessment of the borrower’s financial capacity to service the debt and the presence and value of collateral for the loan. An independent loan review group tests risk assessments and evaluates the adequacy of the allowance for loan losses. Management meets monthly to review the credit quality of the loan portfolio and quarterly to review the allowance for loan losses.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (continued)

Allowance for Loan Losses (continued)

In addition, various regulatory agencies, as an integral part of their examination process, periodically review QNB's allowance for loan losses. Such agencies may require QNB to recognize additions to the allowance based on their judgments using information available to them at the time of their examination.

Management believes that it uses the best information available to make determinations about the adequacy of the allowance and that it has established its existing allowance for loan losses in accordance with GAAP. If circumstances differ substantially from the assumptions used in making determinations, future adjustments to the allowance for loan losses may be necessary and results of operations could be affected. Because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that increases to the allowance will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above.

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

Servicing Assets

Servicing assets are recognized as separate assets when rights are acquired through the sale of financial assets. When mortgage loans are sold, a portion of the cost of originating the loan is allocated to the servicing rights based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The Company subsequently measures servicing rights using the amortization method where servicing rights are amortized in proportion to and over the period of estimated net servicing income. On a quarterly basis an independent third party determines the fair value of QNB's servicing assets. These assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranches. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the valuation allowance may be recorded as an increase to income. Capitalized servicing rights are reported in other assets and are amortized into other noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets. At December 31, 2014 and 2013, the Company had foreclosed assets of $3,025,000 and $2,825,000, respectively. These amounts are included in other assets on the balance sheet.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are calculated principally on an accelerated or straight-line basis over the estimated useful lives of the assets, or the shorter of the estimated useful life or lease term for leasehold improvements, as follows:

Buildings	10 to 40 years
Furniture and Equipment	3 to 10 years

Expenditures for maintenance and repairs are charged to operations as incurred. Gains or losses upon disposition are reflected in earnings as realized.

Bank-Owned Life Insurance

The Bank invests in bank-owned life insurance ("BOLI") as a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Bank on a select group of employees. The Bank is the owner and beneficiary of the policies. Income from the increase in cash surrender value of the policies as well as the receipt of death benefits is included in non-interest income on the income statement.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (continued)

Bank-Owned Life Insurance (continued)

The Company follows the accounting guidance for postretirement benefit aspects of endorsement split-dollar life insurance arrangements which applies to life insurance arrangements that provide an employee with a specified benefit that is not limited to the employee's active service period, including certain bank-owned life insurance policies. It requires an employer to recognize a liability and related compensation costs for future benefits that extend to postretirement periods. The expense recorded during 2014 and 2013 was approximately $21,000 and $19,000, respectively, and is included in non-interest expense under salaries and benefits expense.

Stock-Based Compensation

At December 31, 2014, QNB sponsored stock-based compensation plans, administered by a Board committee, under which both qualified and non-qualified stock options may be granted periodically to certain employees. QNB accounts for all awards granted under stock-based compensation plans in accordance with FASB ASC 718, *Compensation - Stock Compensation*. Compensation cost has been measured using the fair value of an award on the grant date and is recognized over the service period, which is usually the vesting period.

Stock-based compensation expense was approximately $83,000 and $71,000 for the years ended December 31, 2014 and 2013, respectively. There was no tax benefit recognized related to this compensation for the years ended December 31, 2014 and 2013.

The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date. QNB estimated the fair value of stock options on the date of the grant using the Black-Scholes option pricing model. The model requires the use of numerous assumptions, many of which are highly subjective in nature. The following assumptions were used in the option pricing model in determining the fair value of options granted during the periods presented.

Year ended December 31,	2014	2013

Risk free interest rate	0.69 %	0.35 %
Dividend yield	4.28	4.26
Volatility	28.1	34.1
Expected life (years)	5.0	5.0

The weighted average fair value per share of options granted during 2014 and 2013 was $3.81 and $4.52, respectively. The risk-free interest rate was selected based upon yields of U.S. Treasury issues with a term equal to the expected life of the option being valued. Historical information was the primary basis for the selection of the expected dividend yield, expected volatility and expected lives of the options.

Income Taxes

QNB accounts for income taxes under the asset/liability method in accordance with income tax accounting guidance (ASC 740 - *Income Taxes*). Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established against deferred tax assets when, in the judgment of management, it is more likely than not that such deferred tax assets will not become available. Because the judgment about the level of future taxable income is dependent to a great extent on matters that may, at least in part, be beyond QNB's control, it is at least reasonably possible that management's judgment about the need for a valuation allowance for deferred taxes could change in the near term.

In connection with the accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions, QNB has evaluated its tax positions as of December 31, 2014. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that has more than a 50 percent likelihood of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. Under the "more-likely-than-not" threshold guidelines, QNB believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. As of December 31, 2014, QNB had no material unrecognized tax benefits or accrued interest and penalties. QNB's policy is to account for interest as a component of interest expense and penalties as a component of other expense. The Company and its subsidiary are subject to U.S. Federal income tax as well as income tax of the Commonwealth of Pennsylvania. QNB is no longer subject to examination by U.S. Federal or State taxing authorities for years before 2011.

Treasury Stock

Common stock shares repurchased are recorded as treasury stock at cost.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (continued)

Earnings Per Share

Basic earnings per share excludes any dilutive effects of options and is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share gives effect to all dilutive potential common shares that were outstanding during the period. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

Treasury shares are not deemed outstanding for earnings per share calculations.

Comprehensive Income

Comprehensive income is defined as the change in equity of a business entity during a period due to transactions and other events and circumstances, excluding those resulting from investments by and distributions to owners. Comprehensive income consists of net income and other comprehensive income. For QNB, the primary component of other comprehensive income is the unrealized holding gains or losses on available-for-sale investment securities and unrealized losses on available-for-sale investment securities related to factors other than credit on debt securities.

Revenue Recognition

The Company recognizes revenue in the consolidated statements of income as it is earned and when collectability is reasonably assured. The primary source of revenue is interest income from interest earning assets, which is recognized on the accrual basis of accounting using the effective interest method. The recognition of revenues from interest earning assets is based upon formulas from underlying loan agreements, securities contracts or other similar contracts. Non-interest income is recognized on the accrual basis of accounting as services are provided or as transactions occur. Non-interest income includes fees from brokerage and advisory service, deposit accounts, merchant services, ATM and debit card fees, mortgage banking activities, and other miscellaneous services and transactions.

Advertising Costs

Advertising costs are recorded in the period they are incurred within operating expenses in non-interest expense in the consolidated statements of income.

Financial Instruments with Off-Balance-Sheet Risk

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of these instruments. The Company uses the same credit policies in making commitments and contractual obligations as it does for on-balance-sheet instruments. The Company reflects its estimate of credit risk for these instruments in other liabilities on the consolidated balance sheet with the corresponding expense recorded in other operating expenses in the consolidated statement of income.

Subsequent Events

QNB has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2014 for items that should potentially be recognized or disclosed in these consolidated financial statements.

Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-04 – *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The objective of this ASU is to promote uniformity in practice on this topic. The amendment is effective for fiscal years and interim periods within those years beginning after December 15, 2014. The Company does not anticipate the adoption of this guidance will have a material impact on its consolidated financial statements but will result in expanded disclosures.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606). This ASU was issued to help improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. The ASU's core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition. This ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The Company is evaluating the effect of adopting this new ASU.

In August 2014, the FASB issued ASU 2014-14, *Receivables – Troubled Debt Restructurings by Creditors* (Subtopic 310-40). The amendments in this Update require that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The provisions in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Company is currently evaluating the impact the adoption of the standard will have on its financial position or results of operations.

Note 2 – Earnings Per Share and Share Repurchase Plan

The following table sets forth the computation of basic and diluted earnings per share:

Year ended December 31,	**2014**	**2013**
Numerator for basic and diluted earnings per share - net income	$8,998	$8,392
Denominator for basic earnings per share - weighted average shares outstanding	3,291,939	3,248,397
Effect of dilutive securities - employee stock options	10,635	11,678
Denominator for diluted earnings per share - adjusted weighted average shares outstanding	3,302,574	3,260,075
Earnings per share - basic	$2.73	$2.58
Earnings per share - diluted	$2.72	$2.57

There were 28,700 and 49,800 stock options that were anti-dilutive as of December 31, 2014 and 2013, respectively. These stock options were not included in the above calculation.

On January 24, 2008, QNB announced that the Board of Directors authorized the repurchase of up to 50,000 shares of its common stock in open market or privately negotiated transactions. On February 9, 2009, the Board of Directors approved increasing the authorization to 100,000 shares. The repurchase authorization does not bear a termination date. There were no shares repurchased during the years ended December 31, 2014 or 2013. As of December 31, 2014 and 2013, 57,883 shares were repurchased under this authorization at an average price of $16.97 and a total cost of $982,000 and recorded to Treasury stock.

Note 3 – Cash and Cash Equivalents

Included in cash and cash equivalents are reserves in the form of deposits with the Federal Reserve Bank of Philadelphia. As of December 31, 2014 and 2013 QNB was not required to maintain reserves with the Federal Reserve Bank of Philadelphia.

Note 4 - Investment Securities

Trading

Starting in 2014, QNB engaged in trading activities for its own account. Municipal securities that are held principally for resale in the near term are recorded in the trading account at fair value with changes in fair value recorded in net gain on trading activities in non-interest income. There were net realized and unrealized gains of $156,000 for 2014. Unrealized gains on trading activity related to trading securities still held at December, 2014 totaled $24,000. Interest and dividends are included in interest income.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities (continued)

There were no trading securities held by QNB at December 31, 2013. Trading securities, at fair value, at December 31, 2014 were as follows:

December 31, 2014	Fair value
State and municipal	$4,207

Available-For-Sale

The amortized cost and fair values of investment securities available-for-sale at December 31, 2014 and 2013 were as follows:

December 31, 2014	Fair value	Gross unrealized holding gains	Gross unrealized holding losses	Amortized cost
U.S. Government agency	$62,665	$ 212	$ (472)	$ 62,925
State and municipal	72,569	1,500	(150)	71,219
U.S. Government agencies and sponsored enterprises (GSEs):				
Mortgage-backed	136,192	1,819	(466)	134,839
Collateralized mortgage obligations (CMOs)	87,662	330	(1,300)	88,632
Pooled trust preferred	2,439	160	(1,240)	3,519
Corporate debt	6,037	30	-	6,007
Equity	7,655	1,022	(70)	6,703
Total investment securities available-for-sale	$375,219	$ 5,073	$ (3,698)	$ 373,844

December 31, 2013	Fair value	Gross unrealized holding gains	Gross unrealized holding losses	Amortized cost

U.S. Government agency	$71,639	$ 195	$ (1,702)	$ 73,146
State and municipal	87,199	1,023	(1,627)	87,803
U.S. Government agencies and sponsored enterprises (GSEs):				
Mortgage-backed	139,723	1,436	(2,361)	140,648
Collateralized mortgage obligations (CMOs)	75,394	556	(2,334)	77,172
Pooled trust preferred	2,069	85	(1,535)	3,519
Corporate debt	6,021	24	(13)	6,010
Equity	6,625	1,127	(44)	5,542
Total investment securities available-for-sale	$388,670	$ 4,446	$ (9,616)	$ 393,840

The amortized cost and fair value of securities available-for-sale by contractual maturity at December 31, 2014 are shown in the following table. 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. Securities are assigned to categories based on contractual maturity except for mortgage-backed securities and CMOs which are based on the estimated average life of these securities and state and municipal securities which are based on pre-refunded date, if applicable.

December 31, 2014	**Fair value**	**Amortized cost**
Due in one year or less	$9,269	$ 9,170
Due after one year through five years	260,683	260,108
Due after five years through ten years	73,771	73,496
Due after ten years	23,841	24,367
Equity securities	7,655	6,703
Total investment securities available-for-sale	$375,219	$ 373,844

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities (continued)

Proceeds from sales of investment securities available-for-sale were $29,972,000 and $19,559,000 for the years ended December 31, 2014 and 2013, respectively.

The following table presents information related to the Company's gains and losses on the sales of equity and debt securities, and losses recognized for the other-than-temporary impairment (OTTI) of these investments.

December 31,	**2014**				**2013**			
	Gross realized gains	**Gross realized losses**	**Other-than-temporary impairment losses**	**Net gains**	**Gross realized gains**	**Gross realized losses**	**Other-than-temporary impairment losses**	**Net gains**
Equity securities	$1,051	$ (6)	$ -	$1,045	$672	$ -	$ (43)	$629
Debt securities	310	(243)	-	67	196	(1)	-	195
Total	$1,361	$ (249)	$ -	$1,112	$868	$ (1)	$ (43)	$824

The tax expense applicable to the net realized gains were $378,000 and $280,000 for the years ended December 31, 2014 and 2013.

There were no other-than-temporary impairment charges recognized for debt securities still held by QNB for the years ended December 31, 2014 or 2013.

QNB recognizes OTTI for debt securities classified as available-for-sale in accordance with FASB ASC 320, *Investments – Debt and Equity Securities*, which requires that we assess whether we intend to sell or it is more likely than not that the Company will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, the amount of the impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows discounted at the security's effective yield. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and, therefore, is not required to be recognized as a loss in the income statement, but is recognized in other comprehensive income. For equity securities, once a decline in value is determined to be other-than-temporary, the value of the equity security is reduced to fair value and a corresponding charge to earnings is recognized. QNB believes that we will fully collect the carrying value of securities on which we have recorded a non-credit related impairment in other comprehensive income.

The following table presents a rollforward of the credit loss component recognized in earnings. The credit loss component of the amortized cost represents the difference between the present value of expected future cash flows and the amortized cost basis of the security prior to considering credit losses. The beginning balance represents the credit loss component for debt securities for which OTTI occurred prior to the beginning of the year. Credit-impaired debt securities must be presented in two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or is not the first time the debt security was credit-impaired (subsequent credit impairments). No credit impairments were recognized in 2014 or 2013. In November 2014, the Bank sold a pooled trust preferred holding, PreTSL V, which had OTTI recorded in a prior period. The bank recorded a gain on sale of $56,000 for this security, which had a carrying value of $0. The following table presents a summary of the cumulative credit-related other-than-temporary impairment charges recognized as components of earnings for debt securities still held by QNB:

Year ended December 31,	**2014**	**2013**
Balance, beginning of year	$1,271	$1,271
Reductions: sale, collateralized debt obligation	(118)	-
Additions:		
Initial credit impairments	-	-
Subsequent credit impairments	-	-
Balance, end of year	$1,153	$1,271

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities (continued)

Held-To-Maturity

The amortized cost and fair values of investment securities held-to-maturity at December 31, 2014 and December 31, 2013 were as follows:

December 31,	2014				2013			
	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
State and municipal	$146	$ 10	$ -	$156	$146	$ 16	$ -	$162

The amortized cost and fair value of securities held-to-maturity by contractual maturity at December 31, 2014 are shown in the following table. 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.

December 31, 2014	Fair value	Amortized cost
Due in one year or less	-	-
Due after one year through five years	$ 156	$146
Due after five years through ten years	-	-
Due after ten years	-	-
Total investment securities held-to-maturity	$ 156	$146

There were no sales of investment securities classified as held-to-maturity during 2014 or 2013.

At December 31, 2014 and December 31, 2013, investment securities available-for-sale totaling $206,774,000 and $207,868,000, respectively, were pledged as collateral for repurchase agreements and deposits of public funds.

Securities that have been in a continuous unrealized loss position are as follows:

December 31, 2014

		Less than 12 months		12 months or longer		Total	
	No. of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Government agency	29	$15,466	$ (30)	$23,941	$ (442)	$39,407	$ (472)
State and municipal	39	3,452	(31)	11,964	(119)	15,416	(150)
Mortgage-backed	34	6,521	(15)	38,586	(451)	45,107	(466)
Collateralized mortgage obligations (CMOs)	51	2,003	(205)	35,687	(1,095)	37,690	(1,300)
Pooled trust preferred	5	-	-	1,978	(1,240)	1,978	(1,240)
Equity	7	1,303	(70)	-	-	1,303	(70)
Total	165	$28,745	$ (351)	$112,156	$ (3,347)	$140,901	$ (3,698)

December 31, 2013

		Less than 12 months		12 months or longer		Total	
	No. of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Government agency	44	$54,563	$ (1,548)	$2,846	$ (154)	$57,409	$ (1,702)
State and municipal	87	33,750	(1,379)	4,288	(248)	38,038	(1,627)
Mortgage-backed	54	75,720	(2,238)	1,884	(123)	77,604	(2,361)
Collateralized mortgage obligations (CMOs)	45	33,622	(1,413)	18,567	(921)	52,189	(2,334)
Pooled trust preferred	5	-	-	1,683	(1,535)	1,683	(1,535)
Corporate debt	2	1,987	(13)	-	-	1,987	(13)
Equity	3	394	(24)	136	(20)	530	(44)
Total	240	$200,036	$ (6,615)	$29,404	$ (3,001)	$229,440	$ (9,616)

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities (continued)

Management evaluates debt securities, which are comprised of U.S. Government Agencies, state and municipalities, mortgage-backed securities, CMOs and other issuers, for OTTI and considers the current economic conditions, the length of time and the extent to which the fair value has been less than cost, interest rates and the bond rating of each security. The unrealized losses at December 31, 2014 in U.S. Government securities, state and municipal securities, mortgage-backed securities and CMOs are primarily the result of interest rate fluctuations. If held to maturity, these bonds will mature at par, and QNB will not realize a loss. QNB has the intent to hold the securities and does not believe it will be required to sell the securities before recovery occurs.

QNB holds six pooled trust preferred securities as of December 31, 2014. These securities have a total amortized cost of $3,519,000 and a fair value of $2,439,000. Five of the six securities have been in an unrealized loss position for more than twelve months. All of the pooled trust preferred securities are available-for-sale securities and are carried at fair value.

The following table provides additional information related to pooled trust preferred securities (PreTSLs) as of December 31, 2014:

Deal	Class	Book value	Fair value	Unreal-ized gains (losses)	Realized OTTI credit loss (YTD 2014)	Total recognized OTTI credit loss	Moody's /Fitch ratings	Current number of performing banks	Current number of performing insurance companies	Actual deferrals and defaults as a % of total collateral	Total performing collateral as a % of outstanding bonds
	Mezzanine*	$ 243	$ 208	$ (35)	$ -	$ (1)	B1/B	5	-	18.0 %	140.2 %

PreTSL IV											
PreTSL XVII	Mezzanine	752	502	(250)	-	(222)	C/C	34	5	27.3	87.2
PreTSL XIX	Mezzanine	988	508	(480)	-	-	C/C	38	12	13.3	92.4
PreTSL XXV	Mezzanine	766	423	(343)	-	(222)	C/C	48	5	30.7	85.5
PreTSL XXVI	Mezzanine	469	337	(132)	-	(270)	C/C	43	7	25.9	91.0
PreTSL XXVI	Mezzanine	301	461	160	-	(438)	C/C	43	7	25.9	91.0
		$ 3,519	$ 2,439	$ (1,080)	$ -	$ (1,153)					

Mezzanine - only class of bonds still outstanding (represents the senior-most obligation of the trust)*

On January 14, 2014, Regulators released a final interim rule authorizing retention of pooled trust preferred securities backed primarily by bank-issued trust preferred securities which included the PreTSLs held by QNB. During 2014, there was a noticeable increase in trading activity in this market, as sellers disposed of non-exempted trust preferred securities. However, we believe most of these trades occurred under distress and do not represent trades made in an orderly market. Despite the trades that took place as discussed previously, the market for these securities at December 31, 2014 was not active and markets for similar securities also are not active, relative to historical levels of trading activity. The new issue market is also inactive and the market values for these securities are depressed relative to historical levels. Lack of liquidity in the market for trust preferred collateralized debt obligations, credit rating downgrades and market uncertainties related to the financial industry are all factors contributing to the temporary impairment of these securities. Although these securities are classified as available-for-sale, the Company has the intent to hold the securities and does not believe it will be required to sell the securities before recovery occurs. As illustrated in the previous table, these securities are comprised mainly of securities issued by banks, and to a lesser degree, insurance companies. QNB owns the mezzanine tranches of these securities, except for PreTSL IV which represents the senior-most obligation of the trust.

On a quarterly basis management evaluates securities for OTTI, which involves the use of a third-party valuation firm to assist with the valuation. When evaluating these investments a credit-related portion and a non-credit related portion of OTTI are determined.

The credit related portion is recognized in earnings and represents the expected shortfall in future cash flows. The non-credit related portion is recognized in other comprehensive income and represents the difference between the book value and the fair value of the security less any current quarter credit related impairment. For the year ended December 31, 2014, no other-than-temporary impairment charges representing credit impairment were recognized on our pooled trust preferred collateralized debt obligations. A discounted cash flow analysis provides the best estimate of credit related OTTI for these securities. In addition, a weighting factor was applied to any available trade data when determining the final estimation of fair value. Additional information related to this analysis follows:

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 - Investment Securities (continued)

All of the pooled trust preferred collateralized debt obligations held by QNB are rated lower than AA and are measured for OTTI within the scope of ASC 325 (formerly known as EITF 99-20), *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to be Held by a Transferor in Securitized Financial Assets*, and *Amendments to the Impairment Guidance of EITF Issue No. 99-20* (formerly known as EITF 99-20-1). QNB performs a discounted cash flow analysis on all of its impaired collateralized debt obligation securities to determine if the amortized cost basis of an impaired security will be recovered. In determining whether a credit loss exists, QNB uses its best estimate of the present value of cash flows expected to be collected from the debt security and discounts them at the effective yield implicit in the security at the date of acquisition or the prospective yield for those securities with prior OTTI charges. The discounted cash flow analysis is considered to be the primary evidence when determining whether credit related other-than-temporary impairment exists.

Results of a discounted cash flow test are significantly affected by other variables such as the estimate of future cash flows (including prepayments), credit worthiness of the underlying banks and insurance companies and determination of probability and severity of default of the underlying collateral. The following provides additional information for each of these variables:

Estimate of Future Cash Flows – Cash flows are constructed in an INTEXcalc valuation model. INTEX is a proprietary cash flow model recognized as the industry standard for analyzing all types of structured debt products. It includes each deal’s structural features updated with trustee information, including asset-by-asset detail, as it becomes available. The modeled cash flows are then used to determine if all the scheduled principal and interest payments of the investments will be returned. For purposes of the cash flow analysis, relatively modest rates of prepayment were forecasted (1%). In addition to the base prepayment assumption, due to the enactment of the Dodd-Frank financial legislation additional prepayment analysis was performed. First, trust preferred securities issued by banks with more than $15 billion in total assets at December 31, 2009 were identified. The current credit rating of these institutions was reviewed and it was assumed that any issuer with an investment grade credit rating would prepay their issuance as soon as possible or July 1, 2015 for bank holding company subsidiaries of foreign banking organizations that have relied on Supervision and Regulation Letter SR-01-1. For those institutions rated below investment grade the holding companies’ approximate cost of long-term funding given their rating and marketplace interest rate was estimated. The following assumption was made; any holding company that could refinance for a cost savings of more than 2% will refinance and will do so as soon as possible, or July 1, 2015. Finally, for issuers not impacted by the Tier 1 regulatory capital legislation enacted by the Dodd-Frank Act, the issuers that have shown a recent history of prepayment of both floating rate and fixed rate issues were identified and it was assumed these issuers will prepay as soon as possible.

Credit Analysis – A quarterly credit evaluation is performed for the companies comprising the collateral across the various pooled trust preferred securities. This credit evaluation considers any available evidence and focuses on capitalization, asset quality, profitability, liquidity, stock price performance, whether the institution has received TARP funding and whether the institution has shown the ability to generate additional capital either internally or externally.

Probability of Default – A near-term probability of default is determined for each issuer based on its financial condition and is used to calculate the expected impact of future deferrals and defaults on the expected cash flows. Each issuer in the collateral pool is assigned a near-term probability of default based on individual performance and financial characteristics. Various studies suggest that the rate of bank failures between 1934 and 2008 were approximately 0.36%. Thus, in addition to the specific bank default assumptions used for the near term, future defaults on the individual banks in the analysis for 2015 and beyond the rate used is calculated based on using the above mentioned 36 basis points and factoring that number based on a comparison of key financial ratios of active individual issuers without a short-term probability of default compared to all FDIC insured banks.

Severity of Loss – In addition to the probability of default discussed above, a severity of loss (projected recovery) is determined in all cases. In the current analysis, the severity of loss ranges from 0% to 100% depending on the estimated credit worthiness of the individual issuer. Based on information from various published studies, a 95% severity of loss was utilized for defaults projected in 2015 and thereafter.

In addition to the above factors, the evaluation of impairment also includes a stress test analysis which provides an estimate of future risk for each tranche. This stressed breakpoint is then compared to the level of assets with credit concerns in each tranche. This comparison allows management to identify those pools that are at a greater risk for a future adverse change in cash flows so the asset quality in those pools can be monitored more closely for potential deterioration of credit quality.

Based upon the analysis performed by management as of December 31, 2014, it is probable that we will collect all contractual principal and interest payments on one of our six pooled trust preferred securities, PreTSL XIX. The expected principal shortfall on the remaining pooled trust preferred securities resulted in credit related other-than-temporary impairment charges in previous years. All of these pooled trust preferred securities held by QNB could be subject to additional writedowns in the future if additional deferrals and defaults occur.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses

Major classes of loans are as follows:

December 31,	**2014**	**2013**
Commercial:		
Commercial and industrial	$118,845	$111,339
Construction	23,471	15,929
Secured by commercial real estate	203,534	190,602
Secured by residential real estate	53,077	47,672
State and political subdivisions	44,104	33,773
Loans to depository institutions	-	1,250
Indirect lease financing	7,685	8,364
Retail:		
1-4 family residential mortgages	37,147	29,730
Home equity loans and lines	63,213	59,977
Consumer	4,175	3,116
Total loans	555,251	501,752
Net unearned costs (fees)	31	(36)
Loans receivable	$555,282	$501,716

Loans secured by commercial real estate include all loans collateralized at least in part by commercial real estate. These loans may not be for the expressed purpose of conducting commercial real estate transactions.

Overdrafts are reclassified as loans and are included in consumer loans above and total loans on the balance sheet. At December 31, 2014 and 2013, overdrafts were $142,000 and $138,000, respectively.

QNB generally lends in its trade area which is comprised of Quakertown and the surrounding communities. To a large extent, QNB makes loans collateralized at least in part by real estate. Its lending activities could be affected by changes in the general economy, the regional economy, or real estate values. Other than disclosed in the table above, at December 31, 2014, there were no concentrations of loans exceeding 10% of total loans.

The Company engages in a variety of lending activities, including commercial, residential real estate and consumer transactions. The Company focuses its lending activities on individuals, professionals and small to medium sized businesses. Risks associated with lending activities include economic conditions and changes in interest rates, which can adversely impact both the ability of borrowers to repay their loans and the value of the associated collateral.

Commercial and industrial loans, commercial real estate loans, construction loans and residential real estate loans with a business purpose are generally perceived as having more risk of default than residential real estate loans with a personal purpose and consumer loans. These types of loans involve larger loan balances to a single borrower or groups of related borrowers and are more susceptible to a risk of loss during a downturn in the business cycle. These loans may involve greater risk because the availability of funds to repay these loans depends on the successful operation of the borrower's business. The assets financed are used within the business for its ongoing operation. Repayment of these kinds of loans generally comes from the cash flow of the business or the ongoing conversions of assets, such as accounts receivable and inventory, to cash. Typical collateral for commercial and industrial loans includes the borrower's accounts receivable, inventory and machinery and equipment. Commercial real estate and residential real estate loans secured for a business purpose are originated primarily within the eastern Pennsylvania market area at conservative loan-to-value ratios and often backed by the individual guarantees of the borrowers or owners. Repayment of this kind of loan is dependent upon either the ongoing cash flow of the borrowing entity or the resale of or lease of the subject property. Commercial real estate loans may be affected to a greater extent than residential loans by adverse conditions in real estate markets or the economy because commercial real estate borrowers' ability to repay their loans depends on successful development of their properties, as well as the factors affecting residential real estate borrowers.

Loans to state and political subdivisions are tax-exempt or taxable loans to municipalities, school districts and housing and industrial development authorities. These loans can be general obligations of the municipality or school district repaid through their taxing authority, revenue obligations repaid through the income generated by the operations of the authority, such as a water or sewer authority, or loans issued to a housing and industrial development agency, for which a private corporation is responsible for payments on the loans.

Loans to depository institutions consist of a loan to a commercial bank in Lehigh County, Pennsylvania. This loan is secured by shares of common stock of the borrowing institution.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

Indirect lease financing receivables represent loans to small businesses that are collateralized by equipment. These loans tend to have higher risk characteristics but generally provide higher rates of return. These loans are originated by a third party and purchased by QNB based on criteria specified by QNB. The criteria include minimum credit scores of the borrower, term of the lease, type and age of equipment financed and geographic area. The geographic area primarily represents states contiguous to Pennsylvania. QNB is not the lessor and does not service these loans.

The Company originates fixed-rate and adjustable-rate real estate-residential mortgage loans for personal purposes that are secured by first liens on the underlying 1-4 family residential properties. Credit risk exposure in this area of lending is minimized by the evaluation of the credit worthiness of the borrower, including debt-to-income ratios, credit scores and adherence to underwriting policies that emphasize conservative loan-to-value ratios of generally no more than 80%. Residential mortgage loans granted in excess of the 80% loan-to-value ratio criterion are generally insured by private mortgage insurance.

The real estate-home equity portfolio consists of fixed-rate home equity loans and variable-rate home equity lines of credit. Risks associated with loans secured by residential properties are generally lower than commercial loans and include general economic risks, such as the strength of the job market, employment stability and the strength of the housing market. Since most loans are secured by a primary or secondary residence, the borrower’s continued employment is the greatest risk to repayment.

The Company offers a variety of loans to individuals for personal and household purposes. Consumer loans are generally considered to have greater risk than first or second mortgages on real estate because they may be unsecured, or, if they are secured, the value of the collateral may be difficult to assess and is more likely to decrease in value than real estate. Credit risk in this portfolio is controlled by conservative underwriting standards that consider debt-to-income levels and the creditworthiness of the borrower and, if secured, collateral values.

The Company employs an eight (8) grade risk rating system related to the credit quality of commercial loans, loans to depository institutions, loans to state and political subdivisions and indirect lease financing of which the first four categories are pass categories (credits not adversely rated). The following is a description of the internal risk ratings and the likelihood of loss related to each risk rating.

1 - Excellent - no apparent risk

2 - Good - minimal risk

3 - Acceptable - average risk

4 - Watch List - greater than average risk

5 - Special Mention - potential weaknesses

6 - Substandard - well defined weaknesses

7 - Doubtful - full collection unlikely

8 - Loss - considered uncollectible

The Company maintains a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential problem loans. Each loan officer assigns a rating to commercial loans, loans to depository institutions, loans to state and political subdivisions and indirect lease financing at the time the loan is originated. Loans with risk ratings of one through three are reviewed annually based on the borrower's fiscal year. Loans with risk ratings of four are reviewed every six to twelve months based on the dollar amount of the relationship with the borrower. Loans with risk ratings of five through eight are reviewed at least quarterly, and as often as monthly, at management's discretion. The Company also utilizes an outside loan review firm to review the portfolio on a semi-annual basis to provide the Board of Directors and senior management an independent review of the Bank's loan portfolio on an ongoing basis. These reviews are designed to recognize deteriorating credits in their earliest stages in an effort to reduce and control risk in the lending function as well as identifying potential shifts in the quality of the loan portfolio. The examinations by the outside loan review firm include the review of lending activities with respect to underwriting and processing new loans, monitoring the risk of existing loans and to provide timely follow-up and corrective action for loans showing signs of deterioration in quality. In addition, the outside firm reviews the methodology for the allowance for loan losses to determine compliance to policy and regulatory guidance.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard and doubtful within the Company's internal risk rating system as of December 31, 2014 and 2013:

December 31, 2014	**Pass**	**Special mention**	**Substandard**	**Doubtful**	**Total**
Commercial:					
Commercial and industrial	$111,560	$ 42	$ 7,243	$ -	$118,845
Construction	22,981	128	362	-	23,471
Secured by commercial real estate	178,339	2,418	22,777	-	203,534
Secured by residential real estate	50,172	408	2,497	-	53,077
State and political subdivisions	42,771	-	1,333	-	44,104
Loans to depository institutions	-	-	-	-	-
Indirect lease financing	7,543	-	142	-	7,685
	$413,366	$ 2,996	$ 34,354	$ -	$450,716

December 31, 2013	**Pass**	**Special mention**	**Substandard**	**Doubtful**	**Total**
Commercial:					
Commercial and industrial	$100,943	$ 59	$ 10,337	$ -	$111,339
Construction	13,751	827	1,351	-	15,929
Secured by commercial real estate	163,349	4,199	23,054	-	190,602
Secured by residential real estate	43,854	187	3,631	-	47,672
State and political subdivisions	33,488	-	285	-	33,773
Loans to depository institutions	1,250	-	-	-	1,250
Indirect lease financing	8,199	-	165	-	8,364
	$364,834	$ 5,272	$ 38,823	$ -	$408,929

For retail loans, the Company evaluates credit quality based on the performance of the individual credits. The following tables present the recorded investment in the retail classes of the loan portfolio based on payment activity as of December 31, 2014 and 2013:

December 31, 2014	**Performing**	**Non-performing**	**Total**

Retail:			
1-4 family residential mortgages	$ 36,922	$ 225	$37,147
Home equity loans and lines	63,109	104	63,213
Consumer	4,174	1	4,175
	$ 104,205	$ 330	$104,535

December 31, 2013	**Performing**	**Non-performing**	**Total**
Retail:			
1-4 family residential mortgages	$ 29,329	$ 401	$29,730
Home equity loans and lines	59,712	265	59,977
Consumer	3,099	17	3,116
	$ 92,140	$ 683	$92,823

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio (excluding deferred fees and costs) summarized by the past due status, regardless of whether the loan is on non-accrual status, as of December 31, 2014 and 2013:

December 31, 2014	**30-59 days past due**	**60-89 days past due**	**90 days or more past due**	**Total past due loans**	**Current**	**Total loans receivable**
Commercial:						
Commercial and industrial	-	-	-	-	$118,845	$118,845
Construction	$466	-	-	$466	23,005	23,471
Secured by commercial real estate	28	$332	$3,747	4,107	199,427	203,534
Secured by residential real estate	600	574	-	1,174	51,903	53,077
State and political subdivisions	-	-	-	-	44,104	44,104
Loans to depository institutions	-	-	-	-	-	-
Indirect lease financing	291	-	-	291	7,394	7,685
Retail:						
1-4 family residential mortgages	526	-	-	526	36,621	37,147
Home equity loans and lines	66	49	-	115	63,098	63,213
Consumer	16	8	-	24	4,151	4,175
	$1,993	$963	$3,747	$6,703	$548,548	$555,251

December 31, 2013	**30-59 days past due**	**60-89 days past due**	**90 days or more past**	**Total past due loans**	**Current**	**Total loans receivable**

			due			
Commercial:						
Commercial and industrial	$112	-	$17	$129	$111,210	$111,339
Construction	-	-	-	-	15,929	15,929
Secured by commercial real estate	1,126	$361	255	1,742	188,860	190,602
Secured by residential real estate	1,242	98	105	1,445	46,227	47,672
State and political subdivisions	65	65	-	130	33,643	33,773
Loans to depository institutions	-	-	-	-	1,250	1,250
Indirect lease financing	311	152	-	463	7,901	8,364
Retail:						
1-4 family residential mortgages	752	5	270	1,027	28,703	29,730
Home equity loans and lines	295	2	106	403	59,574	59,977
Consumer	25	5	17	47	3,069	3,116
	$3,928	$688	$770	$5,386	$496,366	$501,752

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

The following tables disclose the recorded investment in loans receivable that are either on non-accrual status or past due 90 days or more and still accruing interest as of December 31, 2014 and 2013:

December 31, 2014	**90 days or more past due (still accruing)**	**Non-accrual**
Commercial:		
Commercial and industrial	$ -	$ 2,171
Construction	-	337
Secured by commercial real estate	-	6,465
Secured by residential real estate	-	1,467
State and political subdivisions	-	-
Loans to depository institutions	-	-
Indirect lease financing	-	-
Retail:		
1-4 family residential mortgages	-	225
Home equity loans and lines	-	104
Consumer	-	1
	$ -	$ 10,770

December 31, 2013	**90 days or more past due (still accruing)**	**Non-accrual**

Commercial:		
Commercial and industrial	-	$ 3,956
Construction	-	1,319
Secured by commercial real estate	-	4,630
Secured by residential real estate	-	2,829
State and political subdivisions	-	-
Loans to depository institutions	-	-
Indirect lease financing	-	37
Retail:		
1-4 family residential mortgages	-	401
Home equity loans and lines	-	265
Consumer	$ 1	16
	$ 1	$ 13,453

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

Activity in the allowance for loan losses for the years ended December 31, 2014 and 2013 are as follows:

Year ended December 31, 2014	**Balance, beginning of year**	**Provision for (credit to) loan losses**	**Charge-offs**	**Recoveries**	**Balance, end of year**
Commercial:					
Commercial and industrial	$ 2,044	$ (202)	$ (17)	$ 67	$ 1,892
Construction	439	(142)	-	-	297
Secured by commercial real estate	2,898	(131)	(70)	3	2,700
Secured by residential real estate	1,632	1,019	(1,069)	48	1,630
State and political subdivisions	186	35	-	-	221
Loans to depository institutions	4	(4)	-	-	-
Indirect lease financing	103	15	(39)	14	93
Retail:					
1-4 family residential mortgages	303	103	(95)	1	312
Home equity loans and lines	583	(84)	(156)	110	453
Consumer	64	142	(167)	46	85
Unallocated	669	(351)	N/A	N/A	318
	$ 8,925	$ 400	$ (1,613)	$ 289	$ 8,001

Year ended December 31, 2013	**Balance, beginning of year**	**Provision for (credit to) loan losses**	**Charge-offs**	**Recoveries**	**Balance, end of year**
Commercial:					
Commercial and industrial	$ 2,505	$ (421)	$ (68)	$ 28	$ 2,044

Construction	209	230	-	-	439
Secured by commercial real estate	3,795	(259)	(639)	1	2,898
Secured by residential real estate	1,230	743	(401)	60	1,632
State and political subdivisions	260	(75)	-	1	186
Loans to depository institutions	15	(11)	-	-	4
Indirect lease financing	168	(93)	(2)	30	103
Retail:					
1-4 family residential mortgages	324	(21)	-	-	303
Home equity loans and lines	582	207	(234)	28	583
Consumer	27	88	(77)	26	64
Unallocated	657	12	N/A	N/A	669
	$ 9,772	$ 400	$ (1,421)	$ 174	$ 8,925

As previously discussed, the Company maintains a loan review system, which includes a continuous review of the loan portfolio by internal and external parties to aid in the early identification of potential impaired loans. A loan is considered impaired when, based on current information and events, it is probable that the Company 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 loans, loans to state and political subdivisions and indirect lease financing loans by using 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.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential mortgage loans for impairment disclosures, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

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 the majority of the Company'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 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.

From time to time, QNB may extend, restructure, or otherwise modify the terms of existing loans, on a case-by-case basis, to remain competitive and retain certain customers, as well as assist other customers that may be experiencing financial difficulties. A loan is considered to be a troubled debt restructuring ("TDR") loan when the Company grants a concession to the borrower because of the borrower's financial condition that it would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of principal or interest, or other modifications of interest rates to less than the current market rate for new obligations with similar risk. Loans classified as TDRs are considered non-performing and are also designated as impaired.

The concessions made for TDRs involve lowering the monthly payments on loans through periods of interest only payments, a reduction in interest rate below a market rate or an extension of the term of the loan without a corresponding adjustment to the risk premium reflected in the interest rate, or a combination of these three methods.

The restructurings rarely result in the forgiveness of principal or accrued interest. If the borrower has demonstrated performance under the previous terms and our underwriting process shows the borrower has the capacity to continue to perform under the restructured terms, the loan will continue to accrue interest. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible. TDR loans that are in compliance with their modified terms and that yield a market rate may be removed from the TDR status after a period of performance.

Performing TDRs (not reported as non-accrual or past due 90 days or more and still accruing) totaled $1,897,000 and $1,960,000 as of December 31, 2014 and 2013, respectively. Non-performing TDRs totaled $3,690,000 and $6,601,000 as of December 31, 2014 and 2013, respectively. All TDRs are included in impaired loans.

The following table illustrates the specific reserve for loan losses allocated to loans modified as TDRs. These specific reserves are included in the allowance for loan losses for loans individually evaluated for impairment. There were charge-offs resulting from loans modified as TDRs of $909,000 and $551,000 during the years ended December 31, 2014 and 2013, respectively.

December 31,	**2014**		**2013**	
	Recorded investment (balance)	**Related allowance**	**Recorded investment (balance)**	**Related allowance**
TDRs with no specific allowance recorded	$4,588	-	$5,647	-
TDRs with an allowance recorded	999	$ 813	2,914	$ 1,395
	$5,587	$ 813	$8,561	$ 1,395

The TDR concession made during the year ended December 31, 2014 involved an extension of a maturity date. As of December 31, 2014 and 2013, QNB had commitments of $1,729,000 and $1,603,000, respectively, to lend additional funds to customers with loans whose terms have been modified in troubled debt restructurings.

The following table presents loans, by loan class, modified as TDRs during the years ended December 31, 2014 and 2013. The pre-modification outstanding recorded investment disclosed represents the carrying amounts immediately prior to the modification of the loan.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

Year ended December 31,	**2014**					**2013**				
	Number of contracts	**Pre-modification outstanding recorded investment**		**Post-modification outstanding recorded investment**		**Number of contracts**	**Pre-modification outstanding recorded investment**		**Post-modification outstanding recorded investment**	
Commercial:										
Commercial and industrial	-		-		-	1	$	757	$	757
Construction	-		-		-	2		1,319		1,319
Secured by commercial real estate	-		-		-	1		1,822		1,805
Secured by residential real estate	-		-		-	12		690		676
Retail:										
Home equity loans and lines	1	$	25	$	25	-		-		-
	1	$	25	$	25	16	$	4,588	$	4,557

The following table presents loans modified as TDRs, included above, within the previous 12 months from December 31, 2014 and 2013, for which there was a payment default, past due 60 days or more, during the respective year end:

Year ended December 31,	**2014**			**2013**		
TDRs Subsequently Defaulted	**Number of contracts**	**Recorded investment**		**Number of contracts**	**Recorded investment**	
Commercial:						
Secured by residential real estate	-	$	-	6	$	361
	-	$	-	6	$	361

The following tables present the balance in the allowance of loan losses disaggregated on the basis of the Company's impairment method by class of loans receivable along with the balance of loans receivable by class, excluding unearned fees and costs, disaggregated on the basis of the Company's impairment methodology:

	Allowance for Loan Losses			**Loans Receivable**		
December 31, 2014	**Balance**	**Balance related to loans individually evaluated for impairment**	**Balance related to loans collectively evaluated for impairment**	**Balance**	**Balance individually evaluated for impairment**	**Balance collectively evaluated for impairment**
Commercial:						
Commercial and industrial	$1,892	$ 1,095	$ 797	$118,845	$ 7,115	$ 111,730
Construction	297	-	297	23,471	362	23,109
Secured by commercial real estate	2,700	-	2,700	203,534	11,546	191,988
Secured by residential real estate	1,630	91	1,539	53,077	1,567	51,510
State and political subdivisions	221	-	221	44,104	-	44,104
Loans to depository institutions	-	-	-	-	-	-
Indirect lease financing	93	-	93	7,685	16	7,669
Retail:						
1-4 family residential mortgages	312	4	308	37,147	341	36,806
Home equity loans and lines	453	4	449	63,213	129	63,084
Consumer	85	-	85	4,175	1	4,174
Unallocated	318	N/A	N/A	N/A	N/A	N/A
	$8,001	$ 1,194	$ 6,489	$555,251	$ 21,077	$ 534,174

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

	Allowance for Loan Losses			Loans Receivable		
December 31, 2013	**Balance**	**Balance related to loans individually evaluated for impairment**	**Balance related to loans collectively evaluated for impairment**	**Balance**	**Balance individually evaluated for impairment**	**Balance collectively evaluated for impairment**
Commercial:						
Commercial and industrial	$2,044	$ 1,106	$ 938	$111,339	$ 10,304	$ 101,035
Construction	439	121	318	15,929	1,351	14,578
Secured by commercial real estate	2,898	9	2,889	190,602	12,288	178,314
Secured by residential real estate	1,632	639	993	47,672	2,833	44,839
State and political subdivisions	186	-	186	33,773	-	33,773
Loans to depository institutions	4	-	4	1,250	-	1,250
Indirect lease financing	103	3	100	8,364	37	8,327
Retail:						
1-4 family residential mortgages	303	63	240	29,730	522	29,208
Home equity loans and lines	583	70	513	59,977	266	59,711
Consumer	64	11	53	3,116	16	3,100
Unallocated	669	N/A	N/A	N/A	N/A	N/A
	$8,925	$ 2,022	$ 6,234	$501,752	$ 27,617	$ 474,135

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

The following tables summarize additional information in regards to impaired loans by loan portfolio class as of December 31, 2014 and 2013:

December 31, 2014	**Recorded investment (after charge-offs)**	**Unpaid principal balance**	**Related allowance**	**Average recorded investment**	**Interest income recognized**
With no specific allowance recorded:					
Commercial:					
Commercial and industrial	$ 5,894	$ 6,056	$ -		
Construction	362	444	-		
Secured by commercial real estate	11,546	12,198	-		
Secured by residential real estate	903	1,427	-		
State and political subdivisions	-	-	-		
Loans to depository institutions	-	-	-		
Indirect lease financing	16	16	-		
Retail:					
1-4 family residential mortgages	225	250	-		
Home equity loans and lines	72	93	-		
Consumer	1	1	-		
	$ 19,019	$ 20,485	$ -		
With an allowance recorded:					
Commercial:					
Commercial and industrial	$ 1,221	$ 1,419	$ 1,095		
Construction	-	-	-		
Secured by commercial real estate	-	-	-		
Secured by residential real estate	664	748	91		
State and political subdivisions	-	-	-		
Loans to depository institutions	-	-	-		
Indirect lease financing	-	-	-		
Retail:					
1-4 family residential mortgages	116	116	4		
Home equity loans and lines	57	76	4		

Consumer	-	-	-		
	$ 2,058	$ 2,359	$ 1,194		

Total:

Commercial:					
Commercial and industrial	$ 7,115	$ 7,475	$ 1,095	$ 9,305	$ 331
Construction	362	444	-	1,050	2
Secured by commercial real estate	11,546	12,198	-	12,304	344
Secured by residential real estate	1,567	2,175	91	2,452	-
State and political subdivisions	-	-	-	-	-
Loans to depository institutions	-	-	-	-	-
Indirect lease financing	16	16	-	26	1
Retail:					
1-4 family residential mortgages	341	366	4	460	5
Home equity loans and lines	129	169	4	169	-
Consumer	1	1	-	2	-
	$ 21,077	$ 22,844	$ 1,194	$ 25,768	$ 683

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Loans Receivable and the Allowance for Loan Losses (continued)

December 31, 2013	**Recorded investment (after charge-offs)**	**Unpaid principal balance**	**Related allowance**	**Average recorded investment**	**Interest income recognized**
With no specific allowance recorded:					
Commercial:					
Commercial and industrial	$ 8,222	$ 8,417	$ -		
Construction	916	1,140	-		
Secured by commercial real estate	12,251	12,568	-		
Secured by residential real estate	728	839	-		
State and political subdivisions	-	-	-		
Loans to depository institutions	-	-	-		
Indirect lease financing	13	16	-		
Retail:					
1-4 family residential mortgages	250	274	-		
Home equity loans and lines	135	150	-		
Consumer	-	-	-		
	$ 22,515	$ 23,404	$ -		
With an allowance recorded:					
Commercial:					
Commercial and industrial	$ 2,082	$ 2,350	$ 1,106		
Construction	435	493	121		
Secured by commercial real estate	37	37	9		
Secured by residential real estate	2,105	2,248	639		
State and political subdivisions	-	-	-		
Loans to depository institutions	-	-	-		
Indirect lease financing	24	27	3		
Retail:					
1-4 family residential mortgages	272	284	63		
Home equity loans and lines	131	154	70		
Consumer	16	16	11		
	$ 5,102	$ 5,609	$ 2,022		
Total:					
Commercial:					

Commercial and industrial	$ 10,304	$ 10,767	$ 1,106	$ 6,732	$ 34
Construction	1,351	1,633	121	3,179	46
Secured by commercial real estate	12,288	12,605	9	13,765	399
Secured by residential real estate	2,833	3,087	639	3,090	23
State and political subdivisions	-	-	-	1,636	53
Loans to depository institutions	-	-	-	-	-
Indirect lease financing	37	43	3	63	-
Retail:					
1-4 family residential mortgages	522	558	63	495	5
Home equity loans and lines	266	304	70	293	-
Consumer	16	16	11	1	-
	$ 27,617	$ 29,013	$ 2,022	$ 29,254	$ 560

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 – Premises and Equipment

Premises and equipment, stated at cost less accumulated depreciation and amortization, are summarized below:

December 31,	**2014**	**2013**
Land and buildings	$11,138	$10,763
Furniture and equipment	12,576	12,022
Leasehold improvements	2,313	2,304
Book value	26,027	25,089
Accumulated depreciation and amortization	(16,325)	(15,214)
Net book value	$9,702	$9,875

Depreciation and amortization expense on premises and equipment amounted to $1,167,000 and $1,146,000 for the years ended December 31, 2014 and 2013, respectively.

Note 7 – Intangible Assets and Loan Servicing

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $79,572,000 and $81,750,000 at December 31, 2014 and 2013, respectively.

The following table reflects the activity of mortgage servicing rights for the periods indicated:

Year ended December 31,	**2014**	**2013**
Balance at beginning of year	$519	$448
Mortgage servicing rights capitalized	48	126
Mortgage servicing rights amortized	(71)	(92)
Fair market value adjustments	8	37
Balance at end of year	$504	$519

The balance of these mortgage servicing rights are included in other assets at December 31, 2014 and 2013 and the fair value of these rights was $601,000 and $643,000, respectively. The fair value of servicing rights was determined using discount rates ranging from 10% to 12% for both 2014 and 2013.

The annual estimated amortization expense of intangible assets for each of the five succeeding fiscal years is as follows:

2015	$92
2016	76
2017	63
2018	52
2019	43

On November 26, 2014, QNB transferred its former internet domain name to a third party and recorded a gain of $1,000,000, as disclosed in a Form 8-K filing dated December 2, 2014. As a result of the purchase of an additional domain name, QNB recorded the purchase price of $8,000 as an intangible asset in other assets in 2014. This asset has no amortization expense as it has an indefinite life.

Note 8 - Time Deposits

The aggregate amount of time deposits, including deposits in denominations of $100,000 or more, was $243,247,000 and $239,545,000 at December 31, 2014 and 2013, respectively. Time deposits that meet or exceed the FDIC insurance limit of $250,000 at December 31, 2014 and 2013 were $34,118,000 and $29,765,000, respectively.

At December 31, 2014, the scheduled maturities of time deposits were as follows:

2015	$115,347
2016	49,873
2017	34,615
2018	23,019

2019	20,393
Thereafter	-
Total time deposits	$243,247

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Short-Term Borrowings

December 31,	Securities sold under agreements to repurchase (a)		Other short-term borrowings (b)	
2014				
Balance	$ 35,189		$ -	
Maximum indebtedness at any month end	35,189		-	
Daily average indebtedness outstanding	29,574		2,042	
Average rate paid for the year	0.37	%	0.30	%
Average rate on period-end borrowings	0.37		-	
2013				
Balance	$ 35,156		$ -	
Maximum indebtedness at any month end	35,156		-	
Daily average indebtedness outstanding	29,684		59	
Average rate paid for the year	0.37	%	0.21	%
Average rate on period-end borrowings	0.37		-	

(a) Securities sold under agreements to repurchase mature overnight. The repurchase agreements were collateralized by U.S. Government mortgage-backed securities and CMOs with an amortized cost of $47,501,000 and $54,983,000 and a fair value of $47,719,000 and $54,441,000 at December 31, 2014 and 2013, respectively. These securities are held in safekeeping at the Federal Reserve Bank of Philadelphia.

(b) Other short-term borrowings include Federal funds purchased and overnight borrowings from the FHLB.

The Bank has three unsecured Federal funds lines granted by correspondent banks totaling $31,000,000. Federal funds purchased under these lines were $0 at both December 31, 2014 and 2013.

Note 10 - Long-Term Debt

Under terms of its agreement with the FHLB, QNB maintains otherwise unencumbered qualifying assets (principally 1-4 family residential mortgage loans and U.S. Government and agency notes, bonds, and mortgage-backed securities) in the amount of at least as much as its advances from the FHLB. QNB's FHLB stock of $635,000 and $1,752,000 at December 31, 2014 and 2013, respectively, is also pledged to secure these advances.

QNB has a maximum borrowing capacity with the FHLB of approximately $227,142,000. QNB had no borrowings outstanding with the FHLB at December 31, 2014 or December 31, 2013.

Repurchase agreements are treated as financings with the obligations to repurchase securities sold reflected as a liability in the balance sheet. The dollar amount of securities underlying the agreements remains recorded as an asset, although the securities underlying the agreements are delivered to the broker who arranged the transactions. The broker/dealer who participated with the Company in these agreements is PNC Bank. QNB repaid this borrowing at maturity in 2014.

	2014		**2013**		
Maturity date	**Balance**	**Weighted average rate**	**Balance**	**Weighted average rate**	
2014	$ -	-	$5,000[1]	4.77	%

[1] $2,500,000 callable beginning 4/17/10, $2,500,000 callable beginning 4/17/12

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 – Income Taxes

The components of the provision for income taxes are as follows:

Year ended December 31,	**2014**	**2013**
Current Federal income taxes	$2,276	$2,134
Deferred Federal income taxes	368	212
Net provision	$2,644	$2,346

At December 31, 2014 and 2013, the tax effects of temporary differences that represent the significant portion of deferred tax assets and liabilities are as follows:

December 31,	**2014**	**2013**
Deferred tax assets		
Allowance for loan losses	$2,720	$3,035
Net unrealized holding losses on investment securities available-for-sale	-	1,456
Impaired securities	477	546
Non-credit OTTI on investment securities available-for-sale	204	302
Non-accrual interest income	446	569
OREO expenses	44	41
Deferred rent	64	55
Deferred revenue	27	33
Incurred but not reported (IBNR) medical expense	39	24
Other	48	13
Total deferred tax assets	4,069	6,074
Deferred tax liabilities		
Depreciation	90	231
Mortgage servicing rights	171	176
Net unrealized holding gains on investment securities available-for-sale	671	-
Prepaid expenses	188	149
Other	24	-
Total deferred tax liabilities	1,144	556
Net deferred tax asset	$2,925	$5,518

The ability to realize deferred tax assets is dependent upon a variety of factors, including the generation of future taxable income, the existence of taxes paid and recoverable, the reversal of deferred tax liabilities and tax planning strategies. Based upon these and other factors, management believes it is more likely than not that QNB will realize the benefits of the above deferred tax assets. The net deferred tax asset is included in other assets on the consolidated balance sheet.

A reconciliation of the tax provision on income before taxes computed at the statutory rate of 34% and the actual tax provision was as follows:

Year ended December 31,	**2014**		**2013**	
	Dollar	**%**	**Dollar**	**%**
Provision at statutory rate	$3,958	34.0 %	$3,651	34.0 %
Tax-exempt interest and dividend income	(1,212)	(10.4)	(1,249)	(11.7)
Bank-owned life insurance	(106)	(0.9)	(109)	(1.0)
Life insurance proceeds	(54)	(0.5)	-	-
Stock-based compensation expense	28	0.2	24	0.2
Other	30	0.3	29	0.3
Total provision	$2,644	22.7 %	$2,346	21.8 %

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Employee Benefit Plans

The QNB Bank Retirement Savings Plan provides for elective employee contributions up to the maximum allowed by the IRS and a matching company contribution limited to three percent. In addition, the plan provides for safe harbor non-elective contributions of five percent of total compensation by QNB. QNB contributed a matching contribution of approximately $224,000 and $203,000 for the years ended December 31, 2014 and 2013, respectively, and a safe harbor contribution of approximately $421,000 for 2014 and $388,000 for 2013.

QNB’s Employee Stock Purchase Plan (the Plan) offer eligible employees an opportunity to purchase shares of QNB Corp. common stock at a 10% discount from the lesser of fair market value on the first or last day of each offering period (as defined by the Plan). At the 2011 Annual Meeting, shareholders approved the 2011 Employee Stock Purchase Plan (the 2011 Plan), which authorizes the issuance of 30,000 shares. As of December 31, 2014, 12,790 shares were issued under the 2011 Plan. The 2011 Plan expires May 31, 2016.

Shares issued pursuant to the Plan were as follows:

Year ended December 31,	**2014**	**2013**
Shares	3,239	3,692
Price per share	$22.32 and $23.40	$20.88 and $21.74

Note 13 - Stock Option Plan

QNB has stock option plans (the Plans) administered by a committee which consists of three or more members of QNB’s Board of Directors. The Plans provide for the granting of either (i) Non-Qualified Stock Options (NQSOs) or (ii) Incentive Stock Options (ISOs). The exercise price of an option, as defined by the Plans, is the fair market value of QNB’s common stock at the date of grant. The Plans provide for the exercise either in cash or in securities of the

Company or in any combination thereof.

The 1998 Plan authorizes the issuance of 220,500 shares. The time period by which any option is exercisable under the Plan is determined by the Committee but shall not commence before the expiration of six months after the date of grant or continue beyond the expiration of ten years after the date the option is awarded. The granted options vest after a three-year period. As of December 31, 2014, there were 225,058 options granted, 48,194 options forfeited, 164,814 options exercised and 12,050 options outstanding under this Plan. The 1998 Plan expired March 10, 2008.

The 2005 Plan authorizes the issuance of 200,000 shares. The terms of the 2005 Plan are identical to the 1998 Plan except the options expire five years after the grant date. As of December 31, 2014, there were 163,200 options granted, 54,625 options forfeited, 32,250 options exercised and 76,325 options outstanding under this Plan. The 2005 Plan expires March 15, 2015.

As of December 31, 2014, there was approximately $65,000 of unrecognized compensation cost related to unvested stock option awards granted. That cost is expected to be recognized over the next 25 months.

Stock option activity during 2014 and 2013 was as follows:

	Number of options	**Weighted average exercise price**	**Weighted average remaining contractual term (in years)**	**Aggregate intrinsic value**
Outstanding at December 31, 2012	128,225	$ 22.72		
Exercised	(29,825)	20.23		
Forfeited	(2,600)	19.79		
Granted	20,000	23.20		
Outstanding at December 31, 2013	115,800	23.51		
Exercised	(20,050)	17.82		
Forfeited	(27,375)	29.66		
Granted	20,000	25.16		
Outstanding at December 31, 2014	88,375	$ 23.27	1.97	$ 509
Exercisable at December 31, 2014	38,700	$ 23.29	0.54	$ 248

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Stock Option Plan (continued)

As of December 31, 2014, outstanding stock options consist of the following:

	Options outstanding	**Exercise price**	**Remaining life (in years)**	**Options exercisable**	**Exercise price**
	9,600	$ 17.25	0.13	9,600	$ 17.25
	2,000	19.76	0.69	2,000	19.76
	12,550	20.00	1.07	12,550	20.00
	16,175	21.35	2.07	-	-
	2,500	22.11	1.66	2,500	22.11
	16,850	23.20	3.06	-	-
	16,650	25.16	4.08	-	-
	12,050	32.35	0.05	12,050	32.35
Outstanding at December 31, 2014	88,375	$ 23.27	1.97	38,700	$ 23.29

The tax benefits and intrinsic value related to total stock options exercised during 2014 and 2013 are as follows:

	2014	**2013**
Tax benefits related to stock options exercised	$29	$ 2
Intrinsic value of stock options exercised	161	91

Note 14 - Related Party Transactions

QNB has had, and may be expected to have in the future, banking transactions in the ordinary course of business with is executive officers, directors, principal stockholders, their immediate families and affiliated companies. The following table presents activity and amounts due from directors, principal officers, and their related interests. All of these transactions were made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. These transactions did not involve more than normal risk of collectability or present any other unfavorable features.

Balance, December 31, 2013	$2,817
New Loans	10,360
New Loans - New Director Appointed	8,110
Retired Loans - Executive Resigination	(45)
Repayments	(9,025)
Balance, December 31, 2014	$12,217

Note 15 – Commitments and Contingencies

Financial instruments with off-balance sheet risk:

In the normal course of business there are various legal proceedings, commitments, and contingent liabilities which are not reflected in the financial statements. Management does not anticipate any material losses as a result of these transactions and activities. They include, among other things, commitments to extend credit and standby letters of credit. The maximum exposure to credit loss, which represents the possibility of sustaining a loss due to the failure of the other parties to a financial instrument to perform according to the terms of the contract, is represented by the contractual amount of these instruments. QNB uses the same lending standards and policies in making credit commitments as it does for on-balance sheet instruments. The activity is controlled through credit approvals, control limits, and monitoring procedures.

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

December 31,	**2014**	**2013**
Commitments to extend credit and unused lines of credit	$203,496	$186,137
Standby letters of credit	6,276	5,311
Total financial instrument commitments	$209,772	$191,448

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15 – Commitments and Contingencies (continued)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the 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. QNB evaluates each customer's creditworthiness on a case-by-case basis.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the financial or performance obligation of a customer to a third party. QNB's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making conditional obligations as it does for on-balance sheet instruments. These standby letters of credit expire within two years. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Bank requires collateral and personal guarantees supporting these letters of credit as deemed necessary. The amount of collateral obtained for letters of credit and commitments to extend credit is based on management's credit evaluation of the customer. Collateral varies, but may include real estate, accounts receivable, marketable securities, pledged deposits, inventory or equipment. Management believes that the proceeds obtained through a liquidation of such collateral and the enforcement of personal guarantees would be sufficient to cover the maximum potential amount of future payments required under the corresponding guarantees. The amount of the liability as of December 31, 2014 and 2013 for guarantees under standby letters of credit issued is not material.

Other commitments:

QNB has committed to various operating leases for several of their branch and office facilities. Some of these leases include renewal options as well as specific provisions relating to rent increases. The minimum annual rental commitments under these leases outstanding at December 31, 2014 are as follows:

Minimum lease payments	
2015	$477
2016	477

2017	423
2018	368
2019	341
Thereafter	3,276

Some of the leases contain renewal options to extend the initial terms of the lease for periods ranging from one to five years and certain leases allow for multiple extensions. With the exception of the renewals for a land lease related to a permanent branch site, the commitment for such renewals is not included above if they have not been exercised as of December 31, 2014. Rent expense under leases, which includes common area maintenance costs not included in the minimum lease payments above, for the years ended December 31, 2014 and 2013, was $553,000 and $560,000, respectively.

Note 16 – Accumulated Other Comprehensive Income

The following shows the components of accumulated other comprehensive income during the periods ended December 31, 2014 and 2013:

Year ended December 31,	**2014**	**2013**
Unrealized net holding gains (losses) on available-for-sale securities	$1,975	$(4,281)
Unrealized losses on available-for-sale securities for which a portion of an other-than-temporary impairment loss has been recognized in earnings	(600)	(889)
Accumulated other comprehensive income (loss)	1,375	(5,170)
Tax effect	(468)	1,758
Accumulated other comprehensive income (loss), net of tax	$907	$(3,412)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 – Accumulated Other Comprehensive Income (continued)

The following table presents amounts reclassified out of accumulated other comprehensive income for the years ended December 31, 2014 and 2013:

	Amount reclassified from accumulated other comprehensive income		
Details about accumulated other comprehensive income	**2014**	**2013**	**Affected line item in the statement of income**
Unrealized net holding gains on available-for-sale securities	$1,112	$867	Net gain on sale of investment securities
Other-than-temporary impairment losses on investment securities	-	(43)	Net other-than-temporary impairment losses on investment securities
	1,112	824	
Tax effect	(378)	(280)	Provision for income taxes
Total reclass out of accumulated other comprehensive income, net of tax	$734	$544	Net of tax

Note 17 - Fair Value Measurements and Fair Values of Financial Instruments

Financial Accounting Standards Board ("FASB") ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (fair values are not adjusted for transaction costs). ASC 820 also establishes a framework (fair value hierarchy) for measuring fair value under GAAP, and expands disclosures about fair value measurements.

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 are as follows:

Level 1:	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
Level 2:	Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.
Level 3:	Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The measurement of fair value should be consistent with one of the following valuation techniques: market approach, income approach, and/or cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities (including a business). For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering factors specific to the measurement (qualitative and quantitative). Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the security's relationship to other benchmark quoted securities.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (continued)

For financial assets measured at fair value on a recurring and nonrecurring basis, the fair value measurements by level within the fair value hierarchy used were as follows:

December 31, 2014	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable input (Level 2)**	**Significant unobservable inputs (Level 3)**	**Balance at end of period**
Recurring fair value measurements				
Trading Securities				
State and municipal	-	$ 4,207	-	$4,207
Securities available-for-sale				
U.S. Government agency	-	62,665	-	62,665
State and municipal	-	72,569	-	72,569
U.S. Government agencies and sponsored enterprises (GSEs):				
Mortgage-backed	-	136,192	-	136,192
Collateralized mortgage obligations (CMOs)	-	87,662	-	87,662
Pooled trust preferred	-	-	$ 2,439	2,439
Corporate debt	-	6,037	-	6,037
Equity	$ 7,655	-	-	7,655
Total securities available-for-sale	$ 7,655	$ 365,125	$ 2,439	$375,219
Total recurring fair value measurements	$ 7,655	$ 369,332	$ 2,439	$379,426
Nonrecurring fair value measurements				
Impaired loans	$ -	$ -	$ 3,715	$3,715
Mortgage servicing rights	-	-	112	112
Total nonrecurring fair value measurements	$ -	$ -	$ 3,827	$3,827

December 31, 2013	Quoted prices in active markets for identical assets (Level 1)	Significant other observable input (Level 2)	Significant unobservable inputs (Level 3)	Balance at end of period
Recurring fair value measurements				
Securities available-for-sale				
U.S. Government agency	-	$ 71,639	-	$71,639
State and municipal	-	87,199	-	87,199
U.S. Government agencies and sponsored enterprises (GSEs):				
Mortgage-backed	-	139,723	-	139,723
Collateralized mortgage obligations (CMOs)	-	75,394	-	75,394
Pooled trust preferred	-	-	$ 2,069	2,069
Corporate debt	-	6,021	-	6,021
Equity	$ 6,625	-	-	6,625
Total securities available-for-sale	$ 6,625	$ 379,976	$ 2,069	$388,670
Total recurring fair value measurements	$ 6,625	$ 379,976	$ 2,069	$388,670
Nonrecurring fair value measurements				
Impaired loans	$ -	$ -	$ 3,107	$3,107
Mortgage servicing rights	-	-	192	192
Total nonrecurring fair value measurements	$ -	$ -	$ 3,299	$3,299

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (continued)

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which QNB has utilized Level 3 inputs to determine fair value:

	Quantitative information about Level 3 fair value measurements				
	Fair value	**Valuation techniques**	**Unobservable input**	**Value or range of values**	
December 31, 2014 - Impaired loans	$953	Appraisal of collateral (1)	Appraisal adjustments (2)	-20% to -100	%
			Liquidation expenses (3)	-10	%
December 31, 2014 - Impaired loans	$112	Discounted cash flow (4)	Discount rate	6.375	%
December 31, 2014 - Impaired loans	$2,650	Agreement of sale (5)			
December 31, 2014 - Mortgage servicing rights	$112	Discounted cash flow	Remaining term	2 - 28 yrs	
			Discount rate	10% to 12	%
December 31, 2013 - Impaired loans	$3,107	Appraisal of collateral (1)	Appraisal adjustments (2)	-10% to -30	%
			Liquidation expenses (3)	0%-10	%
December 31, 2013 - Mortgage servicing rights	$192	Discounted cash flow	Remaining term	3 - 29 yrs	
			Discount rate	10% to 12	%

(1) Fair value is primarily determined through appraisals of the underlying collateral by independent parties, which generally includes various level 3 inputs which are not always identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and the age of the appraisal. The range is presented as a percent of the initial appraised value.

(3) Appraisals and pending agreements of sale are adjusted by management for estimated liquidation expenses. The range is presented as a percent of the initial appraised value.

(4) Fair value is determined using the cash flow of the borrower and the effective interest rate of the original note.
(5) Fair value is determined by the net amount due.

The following table presents additional information about the securities available-for-sale measured at fair value on a recurring basis and for which QNB utilized significant unobservable inputs (Level 3 inputs) to determine fair value for the year ended December 31:

	Fair value measurements using significant unobservable inputs (Level 3)	
Securities available-for-sale	**2014**	**2013**
Balance, beginning of year	$2,069	$1,962
Settlements	-	-
Total gains or losses (realized/unrealized)		
Included in earnings	-	-
Included in other comprehensive income	370	107
Transfers in and/or out of Level 3	-	-
Balance, end of year	$2,439	$2,069

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (continued)

There were no transfers in and out of Level 1 and Level 2 fair value measurements during the years ended December 31, 2014 and 2013. There were also no transfers in or out of level 3 for the same periods. There were no losses included in earnings attributable to the change in unrealized gains or losses relating to the available-for-sale securities above with fair value measurements utilizing significant unobservable inputs for the years ended December 31, 2014 and 2013, respectively.

The Level 3 securities consist of six collateralized debt obligation securities, PreTSL securities, which are backed by trust preferred securities issued by banks, thrifts, and insurance companies. As discussed in Note 4, despite the fact that there were some trades during 2014, the market for these securities at December 31, 2014 was not active and markets for similar securities also are not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which PreTSLs trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive and there are currently very few market participants who are willing and or able to transact for these securities.

Given conditions in the debt markets today and the absence of observable transactions in the secondary and new issue markets, we determined:

- The few observable transactions and market quotations that are available are not reliable for purposes of determining fair value at December 31, 2014;
- An income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than the market approach valuation technique used at prior measurement dates; and
- PreTSLs will be classified within Level 3 of the fair value hierarchy because significant adjustments are required to determine fair value at the measurement date.

The Bank is aware of several factors indicating that recent transactions of PreTSL securities are not orderly including an increased spread between bid/ask prices, lower sales transaction volumes for these types of securities, and a lack of new issuances. As a result, the Bank engaged an independent third party to value the securities using a discounted cash flow analysis. The estimated cash flows are based on specific assumptions about defaults, deferrals and prepayments of the trust preferred securities underlying each PreTSL. The resulting collateral cash flows are allocated to the bond waterfall using the INTEXcalc valuation model. Default rates are calculated based upon a comparison of key financial ratios of active individual issuers without a short-term probability of default compared to all FDIC insured banks. The base loss severity assumption and long-term loss severity assumptions are modeled at 95%. The severity factor for near-term default is vectored to reflect the relative expected performance of the institutions modeled to default, with lower forecasted severities used for the higher quality institutions. Prepayments are modeled to take into account the disruption in the asset-backed securities marketplace and the lack of new pooled trust preferred issuances. For those institutions rated below investment grade the holding companies' approximate cost of long-term funding given their rating and marketplace interest rate was estimated. The following assumption was made; any holding company that could refinance for a cost savings of more than 2% will refinance and will do so as soon as possible, or July 1, 2015. Finally, for issuers not impacted by the Tier 1 regulatory capital legislation enacted by the Dodd-Frank Act, the issuers that have shown a recent history of prepayment of both floating rate and fixed rate issues were identified and it was assumed these issuers will prepay as soon as possible.

The internal rate of return is the pre-tax yield used to discount the best estimate of future cash flows after credit losses. The cash flows have been discounted using estimated market discount rates of 3-month LIBOR plus spreads ranging from 3.78% to 8.54%. The determination of appropriate market discount rates involved the consideration of the following:

- the time value of money
- the price for bearing uncertainty in cash flows
- other factors that would be considered by market participants

The analysis of discount rates involved the review of corporate bond spreads for banks, U.S. Treasury yields, credit default swap rates for financial companies (utilized as a proxy for credit), the swap/LIBOR yield curve and the characteristics of the individual securities being valued. For a further discussion of PreTSL valuation, see Note 4, Investment Securities.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of QNB's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between QNB's disclosures and those of other companies may not be meaningful.

The following methods and assumptions were used to estimate the fair values of each major classification of financial instrument and non-financial asset at December 31, 2014 and 2013:

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (continued)

Cash and cash equivalents, accrued interest receivable and accrued interest payable (carried at cost): The carrying amounts reported in the balance sheet approximate those assets' fair value.

Investment securities: trading (carried at fair value), available-for-sale (carried at fair value) and held-to-maturity (carried at amortized cost): The fair value of securities are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. Level 2 debt securities are valued by a third-party pricing service commonly used in the banking industry. Level 2 fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution date, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) were used to support fair values of certain Level 3 investments.

Restricted investment in bank stocks (carried at cost): The fair value of stock in Atlantic Community Bankers Bank and the Federal Home Loan Bank is the carrying amount, based on redemption provisions, and considers the limited marketability of such securities.

Loans Held for Sale (carried at lower of cost or fair value): The fair value of loans held for sale is determined, when possible, using quoted secondary market prices. If no such quoted prices exist, the fair value of a loan is determined using quoted prices for a similar loan or loans, adjusted for the specific attributes of that loan.

Loans Receivable (carried at cost): The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (generally carried at fair value): Impaired loans are loans, in which the Company has measured impairment generally based on the fair value of the loan’s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements. Included in the fair value of impaired loans at December 31, 2014 and 2013 are $2,851,000 and $27,000, respectively, of loans that had no specific reserves required at year end; however, were partially charged-off at year end.

Mortgage Servicing Rights (carried at lower of cost or fair value): The fair value of mortgage servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The mortgage servicing rights are stratified into tranches based on predominant characteristics, such as interest rate, loan type and investor type. The valuation incorporates assumptions that market participants would use in estimating future net servicing income.

Foreclosed assets (other real estate owned and repossessed assets): Foreclosed assets are the only non-financial assets valued on a non-recurring basis which are held by the Company at fair value, less cost to sell. At foreclosure or repossession, if the fair value, less estimated costs to sell, of the collateral acquired (real estate, vehicles, equipment) is less than the Company’s recorded investment in the related loan, a write-down is recognized through a charge to the allowance for loan losses. Additionally, valuations are periodically performed by management and any subsequent reduction in value is recognized by a charge to income. The fair value of foreclosed assets held-for-sale is estimated using Level 3 inputs based on observable market data.

Deposit liabilities (carried at cost): The fair value of deposits with no stated maturity (e.g. demand deposits, interest-bearing demand accounts, money market accounts and savings accounts) are by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). This approach to estimating fair value excludes the significant benefit that results from the low-cost funding provided by such deposit liabilities, as compared to alternative sources of funding. Deposits with a stated maturity (time deposits) have been valued using the present value of cash flows discounted at rates approximating the current market for similar deposits.

Short-term borrowings (carried at cost): The carrying amount of short-term borrowings approximates their fair values.

Long-term debt (carried at cost): The fair value of securities sold under agreements to repurchase is estimated using discounted cash flow analysis, based on quoted prices for new long-term debt with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a fair value that is deemed to represent the transfer price if the liability were assumed by a third party.

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (continued)

Off-balance-sheet instruments (disclosed at cost): The fair value for the Bank's off-balance sheet instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of the respective period ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year end.

The estimated fair values and carrying amounts of the Company's financial and off-balance sheet instruments are summarized as follows:

			Fair value measurements		
December 31, 2014	**Carrying amount**	**Fair value**	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Financial assets					
Cash and cash equivalents	$18,245	$18,245	$18,245	-	-
Investment securities:					
Trading	4,207	4,207	-	$ 4,207	-

Available-for-sale	375,219	375,219	7,655	365,125	$ 2,439
Held-to-maturity	146	156	-	156	-
Restricted investment in bank stocks	647	647	-	647	-
Loans held-for-sale	380	394	-	394	-
Net loans	547,281	544,126	-	-	544,126
Mortgage servicing rights	504	601	-	-	601
Accrued interest receivable	2,568	2,568	-	2,568	-
Financial liabilities					
Deposits with no stated maturities	$608,345	$608,345	$608,345	-	$ -
Deposits with stated maturities	243,247	244,152	-	$ 244,152	-
Short-term borrowings	35,189	35,189	35,189	-	-
Accrued interest payable	344	344	-	344	-
Off-balance sheet instruments					
Commitments to extend credit	$-	$-	$-	$ -	$ -
Standby letters of credit	-	-	-	-	-

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 17 - Fair Value Measurements and Fair Values of Financial Instruments (continued)

December 31, 2013	Carrying amount	Fair value	Fair value measurements Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial assets					
Cash and cash equivalents	$16,286	$16,286	$16,286	-	-
Investment securities:					
Available-for-sale	388,670	388,670	6,625	$ 379,976	$ 2,069
Held-to-maturity	146	162	-	162	-
Restricted investment in bank stocks	1,764	1,764	-	1,764	-
Net loans	492,791	491,635	-	-	491,635
Mortgage servicing rights	519	643	-	-	643
Accrued interest receivable	2,579	2,579	-	2,579	-
Financial liabilities					
Deposits with no stated maturities	$574,987	$574,987	$574,987	-	$ -
Deposits with stated maturities	239,545	241,959	-	$ 241,959	-
Short-term borrowings	35,156	35,156	35,156	-	-
Long-term debt	5,000	5,056	-	5,056	-
Accrued interest payable	392	392	-	392	-
Off-balance sheet instruments					
Commitments to extend credit	$-	$-	$-	$ -	$ -
Standby letters of credit	-	-	-	-	-

Note 18 – Parent Company Financial Information

Condensed financial statements of QNB Corp. only:

Balance Sheets		
December 31,	**2014**	**2013**
Assets		
Cash and cash equivalents	$48	$24
Investment securities available-for-sale	7,655	6,625
Investment in subsidiary	79,112	69,215
Other assets	3	15
Total assets	$86,818	$75,879
Liabilities		
Other liabilities	$464	$254
Shareholders' equity	$86,354	$75,625
Total liabilities and shareholders' equity	$86,818	$75,879

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 – Parent Company Financial Information (continued)

Statements of Income **Year ended December 31,**	**2014**	**2013**
Dividends from subsidiary	$2,925	$3,512
Interest, dividend and other income	142	99
Securities gains	1,045	629
Total income	4,112	4,240
Expenses	313	285
Income before applicable income taxes and equity in undistributed income of subsidiary	3,799	3,955
Provision for income taxes	292	151
Income before equity in undistributed income of subsidiary	3,507	3,804
Equity in undistributed income of subsidiary	5,491	4,588
Net income	$8,998	$8,392

Statements of Comprehensive Income (Loss) **Year ended December 31,**	**2014** **Before tax amount**	**Tax expense (benefit)**	**Net of tax amount**	**2013** **Before tax amount**	**Tax expense (benefit)**	**Net of tax amount**
Net income	$11,642	$2,644	$8,998	$10,738	$2,346	$8,392
Other comprehensive income:						
Net unrealized holding gains (losses) on securities:						
Unrealized holding gains (losses) arising during the period	7,657	2,604	5,053	(11,098)	(3,774)	(7,324)
Reclassification adjustment for gains included in net income	(1,112)	(378)	(734)	(824)	(280)	(544)
Other comprehensive income (loss)	6,545	2,226	4,319	(11,922)	(4,054)	(7,868)
Total comprehensive income (loss)	$18,187	$4,870	$13,317	$(1,184)	$(1,708)	$524

Statements of Cash Flows Year ended December 31,	2014			2013		
Operating Activities						
Net income	$	8,998		$	8,392	
Adjustments to reconcile net income to net cash provided by operating activities:						
Equity in undistributed income from subsidiary		(5,491	)		(4,588	)
Net securities gains		(1,045	)		(629	)
Stock-based compensation expense		83			71	
Increase in other liabilities		225			-	
Decrease in other assets		12			443	
Deferred income tax provision		29			-	
Net cash provided by operating activities		2,811			3,689	
Investing activities						
Purchase of investment securities		(4,955	)		(3,763	)
Proceeds from sale of investment securities		4,839			2,589	
Net cash used by investing activities		(116	)		(1,174	)
Financing activities						
Cash dividend paid		(3,328	)		(3,130	)
Proceeds from issuance of common stock		628			535	
Tax benefit from exercise of stock options		29			2	
Net cash used by financing activities		(2,671	)		(2,593	)
Increase (decrease) in cash and cash equivalents		24			(78	)
Cash and cash equivalents at beginning of year		24			102	
Cash and cash equivalents at end of	$	48		$	24	

year

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 19 - Regulatory Restrictions

Dividends payable by the Company and the Bank are subject to various limitations imposed by statutes, regulations and policies adopted by bank regulatory agencies. Under Pennsylvania banking law, the Bank is subject to certain restrictions on the amount of dividends that it may declare without prior regulatory approval. Under Federal Reserve regulations, the Bank is limited as to the amount it may lend affiliates, including the Company, unless such loans are collateralized by specific obligations.

Both the Company and the Bank are subject to regulatory capital requirements administered by Federal banking agencies. Failure to meet minimum capital requirements can initiate actions by regulators that could have an effect on the financial statements. Under the framework for prompt corrective action, both the Company and the Bank must meet capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items. The capital amounts and classification are also subject to qualitative judgments by the regulators. Management believes, as of December 31, 2014, that the Company and the Bank met capital adequacy requirements to which they were subject.

As of the most recent notification, the primary regulator of the Bank considered it to be "well capitalized" under the regulatory framework. There are no conditions or events since that notification that management believes have changed the classification. To be categorized as well capitalized, the Company and the Bank must maintain minimum ratios set forth in the table below.

The Company and the Bank's actual capital amounts and ratios are presented as follows:

	Capital levels					
	Actual		**Adequately capitalized**		**Well capitalized**	
As of December 31, 2014	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total risk-based capital (to risk-weighted assets):						
Consolidated	$93,927	14.06%	$53,425	8.00 %	N/A	N/A
Bank	86,884	13.14	52,891	8.00	$66,114	10.00%

Tier 1 capital (to risk-weighted assets):						
Consolidated	85,439	12.79	26,713	4.00	N/A	N/A
Bank	78,824	11.92	26,446	4.00	39,669	6.00
Tier 1 capital (to average assets):						
Consolidated	85,439	8.65	39,501	4.00	N/A	N/A
Bank	78,824	8.04	39,237	4.00	49,047	5.00

	Capital levels					
	Actual		**Adequately capitalized**		**Well capitalized**	
As of December 31, 2013	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total risk-based capital (to risk-weighted assets):						
Consolidated	$87,330	14.01%	$49,871	8.00 %	N/A	N/A
Bank	81,076	13.13	49,402	8.00	$61,753	10.00%
Tier 1 capital (to risk-weighted assets):						
Consolidated	79,037	12.68	24,936	4.00	N/A	N/A
Bank	73,342	11.88	24,701	4.00	37,052	6.00
Tier 1 capital (to average assets):						
Consolidated	79,037	8.45	37,419	4.00	N/A	N/A
Bank	73,342	7.88	37,215	4.00	46,518	5.00

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 20 – Consolidated Quarterly Financial Data (Unaudited)

The unaudited quarterly results of operations for the years ended 2014 and 2013 are in the following table:

	Quarters Ended 2014				**Quarters Ended 2013**			
	March 31	**June 30**	**Sept. 30**	**Dec. 31**	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**
Interest income	$7,527	$7,588	$7,741	$7,814	$7,676	$7,624	$7,678	$7,606
Interest expense	1,134	1,091	1,156	1,163	1,343	1,288	1,226	1,176
Net interest income	6,393	6,497	6,585	6,651	6,333	6,336	6,452	6,430
Provision for loan losses	-	-	-	400	-	100	150	150
Non-interest income	1,812	1,625	1,517	2,588	1,748	1,239	1,553	1,273
Non-interest expense	5,212	5,314	5,478	5,622	4,940	5,091	5,123	5,072
Income before income taxes	2,993	2,808	2,624	3,217	3,141	2,384	2,732	2,481
Provision for income taxes	697	636	580	731	733	490	604	519
Net Income	$2,296	$2,172	$2,044	$2,486	$2,408	$1,894	$2,128	$1,962
Earnings Per Share - basic *	$0.70	$0.66	$0.62	$0.75	$0.75	$0.58	$0.65	$0.60
Earnings Per Share - diluted *	$0.70	$0.66	$0.62	$0.75	$0.74	$0.58	$0.65	$0.60

** Due to rounding, quarterly earnings per share may not sum to annual earnings per share*

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

*a)**Evaluation of Disclosure Controls and Procedures***

Under the supervision and with the participation of QNB's Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO (its principal executive officer and principal financial officer), management has evaluated the effectiveness of the design and operation of QNB's disclosure controls and procedures as of December 31, 2014. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time periods required the Securities and Exchange Commission, or the SEC, and that such information is accumulated and communicated to QNB's management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Based on and as of the date of such evaluation, our CEO and CFO concluded that the design and operation of our disclosure controls and procedures were effective as of the end of the period covered by this Report.

*b)**Internal Control over Financial Reporting***

Information required by this item is set forth in Management's Report and Report of Independent Registered Public Accounting Firm which is incorporated by reference into this item.

*c)**Changes in Internal Control over Financial Reporting***

On May 14, 2013, COSO issued an updated version of its Internal Control – Integrated Framework, referred to as the 2013 COSO Framework and has indicated that after December 15, 2014 the 1992 Framework will be considered superseded after December 31, 2014. Management's assessment of the overall effectiveness of our internal controls over financial reporting for the year ended December 31, 2014 was based on the 1992 COSO Framework. Management will change from the 1992 Framework to the 2013 COSO Framework in 2015 and this change is not expected to be significant to our overall control structure over financial reporting.

There were no changes to the Company's internal controls over financial reporting (as defined in Rule 13a-15(f)) of the Securities Exchange Act) during the quarter ended December 31, 2014 that materially affected, or are reasonably likely to materially affect, the Company's control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 is incorporated by reference to information appearing in QNB Corp.'s definitive proxy statement to be used in connection with the 2015 Annual Meeting of Shareholders under the captions:

- "Election of Directors"
- "Governance of the Company - Code of Ethics"
- "Section 16(a) Beneficial Ownership Compliance"
- "Meetings and Committees of the Board of Directors of QNB and the Bank"
- "Executive Officers of QNB and/or the Bank"

The Company has adopted a Code of Business Conduct and Ethics applicable to its CEO, CFO and Controller as well as its long-standing Code of Ethics which applies to all directors and employees. The codes are available on the Company's website at www.qnbbank.com.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated by reference to the information appearing in QNB Corp.'s definitive proxy statement to be used in connection with the 2015 Annual Meeting of Shareholders under the captions:

- "Compensation Committee Report"
- "Executive Compensation"
- "Director Compensation"
- "Compensation Tables"

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Equity Compensation Plan Information

The following table summarizes QNB's equity compensation plan information as of December 31, 2014. Information is included for both equity compensation plans approved by QNB shareholders and equity compensation plans not approved by QNB shareholders.

Plan Category	Number of shares to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of shares available for future issuance under equity compensation plans [excluding securities reflected in column (a)] (c)
Equity compensation plans approved by QNB shareholders			
1998 Stock option plan	12,050	$ 32.35	-
2005 Stock option plan	76,325	21.84	36,800
2011 Employee stock purchase plan	-	-	17,210
Equity compensation plans not approved by QNB shareholders			
None	-	-	-
Total	88,375	$ 23.27	54,010

Additional information required by Item 12 is incorporated by reference to the information appearing in QNB Corp.'s definitive proxy statement to be used in connection with the 2015 Annual Meeting of Shareholders under the captions:

- "Security Ownership of Certain Beneficial Owners and Management"

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is incorporated by reference to the information appearing in QNB Corp.'s definitive proxy statement to be used in connection with the 2015 Annual Meeting of Shareholders under the captions:

- "Certain Relationships and Related Party Transactions"
- "Governance of the Company - Director Independence"

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 is incorporated by reference to the information appearing in QNB Corp.'s definitive proxy statement to be used in connection with the 2015 Annual Meeting of Shareholders under the captions:

- "Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors"
- "Audit Fees, Audit Related Fees, Tax Fees, and All Other Fees"

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) 1. Financial Statements

The following financial statements are included by reference in Part II, Item 8 hereof.

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Income

Consolidated Statements of Comprehensive Income (Loss)

Consolidated Statements of Shareholders' Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

2. Financial Statement Schedules

The financial statement schedules required by this Item are omitted because the information is either inapplicable, not required or is in the consolidated financial statements as a part of this Report.

3. The following exhibits are incorporated by reference herein or annexed to this Form 10-K:

3(i)-	Articles of Incorporation of Registrant, as amended.
3(ii)-	By-laws of Registrant, as amended.
10.1-	QNB Corp. 1998 Stock Incentive Plan. (Incorporated by reference to Exhibit 4.3 to Registration Statement No. 333-91201 on Form S-8, filed with the Commission on November 18, 1999)
10.2-	QNB Corp. 2005 Stock Incentive Plan. (Incorporated by reference to Exhibit 99.1 to Registration Statement No. 333-125998 on Form S-8, filed with the Commission on June 21, 2005)
10.3-	QNB Corp. 2011 Employee Stock Purchase Plan. (Incorporated by reference to Exhibit 99.1 to Registration Statement No. 333-175788 on Form S-8, filed with the Commission on July 26, 2011)
10.4-	Employment Agreement between Registrant and David W. Freeman. (Incorporated by reference to Exhibit 10.1 of Registrant’s Current Report on Form 8-K, SEC File No. 0-17706, filed with the Commission on December 28, 2012)
10.5-	Change of Control Agreement between Registrant and Scott G. Orzehoski. (Incorporated by reference to Exhibit 10.1 of Registrant’s Quarterly Report on Form 10-Q, SEC File No. 0-17706, filed with the Commission on November 9, 2011)
10.6-	Change of Control Agreement between Registrant and Jennifer L. Frost. (Incorporated by reference to Exhibit 10.8 of Registrant’s Annual Report on Form 10-K, SEC File No. 0-17706, filed with the Commission on March 29, 2013)
10.7-	Change of Control Agreement between Registrant and Dale A. Wentz. (Incorporated by reference to Exhibit 10.9 of Registrant’s Annual Report on Form 10-K, SEC File No. 0-17706, filed with the Commission on March 29, 2013)
10.8-	Change of Control Agreement between Registrant and Janice McCracken Erkes. (Incorporated by reference to Exhibit 10.1 of Registrant’s Current Report on Form 8-K, SEC File No. 0-17706, filed with the Commission on September 8, 2014)

21- Subsidiaries of the Registrant

23.1- Consent of Independent Registered Public Accounting Firm

31.1-Section 302 Certification of the Chief Executive Officer

31.2-Section 302 Certification of the Chief Financial Officer

32.1-Section 906 Certification of the Chief Executive Officer

32.2-Section 906 Certification of the Chief Financial Officer

The following Exhibits are being furnished * as part of this report:

No.	**Description**
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema Document *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document *
101.LAB	XBRL Taxonomy Extension Label Linkbase Document *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document *
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document *

* These interactive data files are being furnished as part of this Annual Report, and, in accordance with Rule 402 of Regulation S-T, shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	QNB Corp.	
March 10, 2015	BY:	/s/ David W. Freeman
		David W. Freeman
		Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report is signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ David W. Freeman David W. Freeman	Chief Executive Officer, Principal Executive Officer and Director	March 10, 2015
/s/ Janice McCracken Erkes Janice McCracken Erkes	Chief Financial Officer and Principal Financial and Accounting Officer	March 10, 2015
/s/ Autumn R. Bayles Autumn R. Bayles	Director	March 10, 2015
/s/ Thomas J. Bisko Thomas J. Bisko	Director	March 10, 2015
/s/ Kenneth F. Brown, Jr. Kenneth F. Brown, Jr.	Director	March 10, 2015
/s/ Dennis Helf Dennis Helf	Director, Chairman	March 10, 2015
/s/ G. Arden Link G. Arden Link	Director	March 10, 2015

/s/ Anna Mae Papso Anna Mae Papso	Director	March 10, 2015
/s/ Gary S. Parzych Gary S. Parzych	Director	March 10, 2015
/s/ Henry L. Rosenberger Henry L. Rosenberger	Director	March 10, 2015
/s/ W. Randall Stauffer W. Randall Stauffer	Director	March 10, 2015

QNB CORP.

FORM 10-K

FOR YEAR ENDED DECEMBER 31, 2014

EXHIBIT INDEX

Exhibit

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10.3-	QNB Corp. 2011 Employee Stock Purchase Plan. (Incorporated by reference to Exhibit 99.1 to Registration Statement No. 333-175788 on Form S-8, filed with the Commission on July 26, 2011)
10.4-	Employment Agreement between Registrant and David W. Freeman. (Incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K, SEC File No. 0-17706, filed with the Commission on December 28, 2012)
10.5-	Change of Control Agreement between Registrant and Scott G. Orzehoski. (Incorporated by reference to Exhibit 10.1 of Registrant's Quarterly Report on Form 10-Q, SEC File No. 0-17706, filed with the Commission on November 9, 2011)
10.6-	Change of Control Agreement between Registrant and Jennifer L. Frost. (Incorporated by reference to Exhibit 10.8 of Registrant's Annual Report on Form 10-K, SEC File No. 0-17706, filed with the Commission on March 29, 2013)
10.7-	Change of Control Agreement between Registrant and Dale A. Wentz. (Incorporated by reference to Exhibit 10.9 of Registrant's Annual Report on Form 10-K, SEC File No. 0-17706, filed with the Commission on March 29, 2013)

10.8 - Change of Control Agreement between Registrant and Janice McCracken Erkes. (Incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K, SEC File No. 0-17706, filed with the Commission on September 8, 2014)

21 - Subsidiaries of the Registrant

23.1 - Consent of Independent Registered Public Accounting Firm

31.1 - Section 302 Certification of the Chief Executive Officer

31.2 - Section 302 Certification of the Chief Financial Officer

32.1 - Section 906 Certification of the Chief Executive Officer

32.2 - Section 906 Certification of the Chief Financial Officer

The following Exhibits are being furnished * as part of this report:

No.	**Description**
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema Document *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document *
101.LAB	XBRL Taxonomy Extension Label Linkbase Document *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document *
101.DEF	XBRL Taxonomy Extension Definitions Linkbase Document *

* These interactive data files are being furnished as part of this Annual Report, and, in accordance with Rule 402 of Regulation S-T, shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.