

**IMPACT OF SOX ON THE BANKING & FINANCE INDUSTRY**  
**Adverse Section 404 Reports**  
**For Companies with Years Ended in 2006**  
**As of July 6, 2007**

The following is a copy of the eleven adverse reports that were issued from companies in the Banking & Finance industry with years ended in 2006. These were all of the accelerated filers in the Banking & Finance industry with adverse Sarbanes-Oxley Section 404 management self assessments. This information was gathered using the online research tool called Audit Analytics an Ives Group, Inc company.

The following is a summary of the **material internal control weaknesses** reported in the eleven adverse Section 404 Self Assessments:

Internal Controls - Accounting documentation, policy and/or procedures	11
Internal Controls - Material and/or numerous auditor /YE adjustments	8
Internal Controls - Accounting personnel resources, competency/training	4
Internal Controls - Senior management competency, tone, reliability issues	2
Internal Controls - SAB 108 adjustments noted	2
Internal Controls - Non-routine transaction control issues	2
Internal Controls - Untimely or inadequate account reconciliations	1
Internal Controls - Restatement or nonreliance of company filings	1
Internal Controls - Ethical or compliance issues with personnel	1

The following is a summary of the **material accounting weaknesses** reported in the eleven adverse Section 404 Self Assessments. Section 404 is not just about internal control issues, but also about misapplication of financial accounting and reporting issues:

Accounting - Accounts/loans receivable, investments & cash issues	7
Accounting - Revenue recognition issues	3
Accounting - Foreign, related party, affiliated and/or subsid issues	2
Accounting - Liabilities, payables, reserves and accrual est failures	2
Accounting - Tax expense/benefit/deferral/other (FAS 109) issues	2
Accounting - Acquisition, merger, disposal or reorganization issues	1
Accounting - Expense recording (payroll, SG&A) issues	1



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## **FARMERS CAPITAL BANK CORP**

### **10-K 2006 Management - Internal Control Assessment**

Management's Report on Internal Control Over Financial Reporting Management Responsibility. The management of Farmers Capital Bank Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system is designed to provide reasonable assurance to Company's management and Board of Directors regarding the reliability of financial reporting and the presentation of published financial statements. However, all internal control systems, no matter how well designed, have inherent limitations. General Description of Internal Control over Financial Reporting. Internal control over financial reporting refers to a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer and effected by the Company's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: · Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of Company assets; · Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that Company's receipts and expenditures are being made only in accordance with the authorization of Company's management and members of the Company's Board of Directors; and · Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisitions, uses or dispositions of Company assets that could have a material effect on the Company's financial statements. Inherent Limitations in Internal Control over Financial Reporting. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented or overridden by collusion or other improper activities. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk. Management's Assessment of the Company's Internal Control over Financial Reporting. We assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In making this assessment, we used the criteria for effective internal control over financial reporting set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control-Integrated Framework." This assessment excluded the internal control over financial reporting for Citizens National Bank of Jessamine County ("Citizens Jessamine") as permitted by the Securities and Exchange Commission for current year acquisitions. Citizens National Bancshares, Inc., the former parent company of Citizens Jessamine, was acquired by the Company on October 1, 2006. Citizens Jessamine represented 9.4% of the Company's consolidated assets at December 31, 2006 and 1.1% of the Company's consolidated net income for 2006. As a result of our assessment of the Company's internal control over financial reporting, we conclude that the Company's internal control over financial reporting was effective as of December 31, 2006 to ensure that information required to be disclosed by the Company in reports that it files or

submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. Auditor Assessment. Our assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006 has been audited by Crowe Chizek and Company LLC. As stated in their report, which appears herein, Crowe Chizek and Company LLC believes that a material weakness in internal control over financial reporting existed at December 31, 2006 and, accordingly, that the Company's internal control over financial reporting was not effective at that date.

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## **FNB United Corp.**

### **10-K 2006 Management - Internal Control Assessment**

#### MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of FNB United Corp. (the "Corporation") is responsible for preparing the Corporation's annual consolidated financial statements and for establishing and maintaining adequate internal control over financial reporting for the Corporation. Management has evaluated the effectiveness of the Corporation's internal control over financial reporting, including controls over the preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C), as of December 31, 2006 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a control deficiency, or combination of control deficiencies, that results in a more than remote likelihood that a material misstatement of the annual or interim financial statement will not be prevented or detected. As of December 31, 2006, the Corporation did not have controls designed and in place for nonroutine transactions such as the restructuring of the Corporation's investment portfolio that occurred in the third quarter of 2006. This control deficiency resulted in the restatement of the Corporation's interim consolidated financial statements for the third quarter of 2006. Because of this material weakness, management has concluded that the Corporation did not maintain effective internal control over financial reporting as of December 31, 2006 based on criteria established in Internal Control—Integrated Framework issued by the COSO.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. 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.

Management has excluded certain controls of Integrity Financial Corporation, which was acquired by the Corporation on April 28, 2006, from its assessment. While many of the internal controls over financial reporting applicable to Integrity were integrated with those of the Corporation as of December 31, 2006, and therefore included in management's assessment, the controls regarding the Integrity branch locations had not yet been integrated

as of December 31, 2006.

Dixon Hughes PLLC, an independent, registered public accounting firm, has audited the Corporation's consolidated financial statements as of and for the year ended December 31, 2006 included in this annual report, and has issued an attestation report on management's assessment of the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2006, which is included herein.

Management is also responsible for compliance with laws and regulations relating to safety and soundness which are designated by the FDIC and the appropriate federal banking agency. Management assessed its compliance with these designated laws and regulations relating to safety and soundness and believes that the Corporation complied, in all significant respects, with such laws and during the year ended December 31, 2006.

March 26, 2007

FNB United Corp.

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## **BANK MUTUAL CORP**

### **10-K 2006 Management - Internal Control Assessment**

Management's Report on Internal Control Over Financial Reporting The 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 generally accepted accounting principles. Our 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 company are being made only in accordance with authorization of management and directors of the company; 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. Management of Bank Mutual Corporation is responsible for establishing and maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Bank Mutual Corporation's management, including its chief executive officer and chief financial officer, has assessed the effectiveness of its internal control over financial reporting as of December 31, 2006, based on the criteria established in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In performing this assessment, management considered the implications of certain errors identified by the Company's independent registered public accounting firm in conjunction with their audit of the Company's consolidated financial statements for the year ended December 31, 2006. These errors related to the accounting policies for defined benefit plans as required by SFAS No. 87 "Employers' Accounting for Pensions" and the incorrect application of these accounting policies to the Company's non-qualified pension plans. This incorrect application of accounting policies resulted in the Company overstating an asset and understating expense. The error has been corrected in accordance with SAB No. 108, whereby shareholders' equity and other assets have been adjusted as of January 1, 2006. A material weakness in internal control over financial

reporting is a significant deficiency (within the meaning of the Public Company Accounting Oversight Board ("PCAOB") Auditing Standard No. 2), or combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. PCAOB Auditing Standard No. 2 identifies a number of circumstances that, because of their likely significant negative effect on internal control over financial reporting, are to be regarded as at least significant deficiencies as well as strong indicators that a material weakness exists. Management evaluated the Company's assessment of its system of internal control and has concluded that the control deficiency over the application of its accounting policies for the accounting of non-qualified pension plans that resulted in the above-described errors represented a material weakness. Solely as a result of this material weakness, management has concluded that, as of December 31, 2006, the Company's internal control over financial reporting was not effective based on the criteria set forth by the COSO of the Treadway Commission in Internal Control — Integrated Framework. Ernst & Young LLP, independent registered public accounting firm, has issued an attestation report on management's assessment of Bank Mutual Corporation's internal control over financial reporting. That attestation report can be found on the following page as part of this Item 9A.

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## **COMMERCE BANCORP INC /NJ/**

### **10-K 2006 Management - Internal Control Assessment**

Commerce Bancorp, Inc. Report on Management's Assessment of Internal Control Over Financial Reporting

Commerce Bancorp, Inc.'s management is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

Management of Commerce Bancorp, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rule 13a - 15(f). Internal control over financial reporting includes those policies and procedures that pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; 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 Company are being made only in accordance with authorizations of management and directors of the Company; and 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. The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified.

Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement

preparation.

Management, with the participation of the Company's principal executive officer and principal financial officer, evaluated the effectiveness of the Company's system of internal control over financial reporting as of December 31, 2006, based on the Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission. During the evaluation of the Company's internal control over financial reporting as of December 31, 2006, deficiencies were identified surrounding the evaluation and interpretation of the applicability of tax laws to the Company's activities. Management has determined that these deficiencies represent a material weakness in the Company's internal control over financial reporting. A material weakness, as defined in Public Company Accounting Oversight (PCAOB) Auditing Standard No. 2, is a control deficiency, or aggregation of control deficiencies, that results in more than a remote risk that a material misstatement in the Company's annual or interim financial statements will not be prevented or detected. As a result of this material weakness, the Company concluded that its internal control over financial reporting was not effective as of December 31, 2006.

Ernst & Young LLP, independent registered accounting firm, has issued an attestation report on management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, which is included elsewhere herein. /s/ Vernon W. Hill, II Vernon W. Hill, II President and Chief Executive Officer (Principal Executive Officer) /s/ Douglas J. Pauls Douglas J. Pauls Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

March 16, 2007

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## **COAST FINANCIAL HOLDINGS INC**

### **10-K 2006 Management - Internal Control Assessment**

(b) Internal Control Over Financial Reporting.

Management of the Company is responsible for establishing and maintaining adequate internal control over its financial reporting. The Company's internal control over financial reporting is process designed under the supervision of our Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Table of Contents 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.

The Company's management, under the supervision with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's internal control over financial reporting as of December 2006 based on the criteria set forth by the Committee of Sponsor Organizations of the Treadway Commission (COSO) in "Internal

Control Integrated Framework.”

As a result of management’s evaluation and review of our internal controls our financial reporting, management has concluded that the Company did not have sufficient or adequate policies, procedures and controls to monitor and report certain concentrations of risk associated with residential permanent-to-construction loans (“residential construction loans”) underwritten by Coast Bank. Specifically, the Company did not have procedures and controls to identify and monitor concentrations of builders hired by our borrowers for the construction of their homes which were financed with the residential construction loans. Also, the Company did not have procedures and controls to identify and monitor geographic and investor concentrations for its residential construction loans.

Management has undertaken procedures in order to conclude that reasonable assurance exists regarding the reliability of financial reporting and the preparation of the consolidated financial statements contained in this annual report. Accordingly, management believes that the consolidated financial statements included in this Form 10-K fairly present, in all material respects, the Company’s financial position, results of operations, and cash flows for the periods presented.

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## **FIRST CHARTER CORP /NC/**

### **10-K 2006 Management - Internal Control Assessment**

Management’s Annual Report on Internal Control Over Financial Reporting

The Registrant’s management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) promulgated under the Exchange Act). Internal control over financial reporting is a process, designed by, or under the supervision of, an entity’s principal executive and principal financial officers, and effected by an entity’s board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. 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 the dispositions of the assets of the entity; (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 the management and directors of the entity; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the entity’s assets that could have a material effect on its consolidated 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. Under the supervision and with the participation of the Registrant’s management, including the Registrant’s Chief Executive Officer and Chief Financial Officer, the Registrant’s management conducted an assessment of the effectiveness of its internal control over financial reporting based on the criteria set forth in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). A material weakness is a control deficiency, or combination of control

deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected. As of December 31, 2006, management concluded that its internal control over financial reporting was not effective because of the material weaknesses described below. Control Environment A control environment sets the tone of an organization, influences the control consciousness of its people, and is the foundation of all other components of internal control over financial reporting. The Registrant's control environment did not sufficiently promote effective internal control over financial reporting throughout the organization. Specifically, the following deficiencies were identified in the Registrant's control environment as of December 31, 2006:

- A sufficient complement of skilled finance, tax and accounting resources did not exist to perform supervisory reviews and monitoring activities over certain financial reporting matters and controls.

- An adequate tone and control consciousness did not exist to support effective application of policies and the execution of procedures within the daily operation of financial reporting controls.

These deficiencies in the control environment were a contributing factor in the development of the "Significant Transactions and Estimates Accounting" and "Reconciliation Function" material weaknesses described below, and resulted in more than a remote likelihood that material misstatements of the annual or interim financial statements would not be prevented or detected.

Significant Transactions and Estimates Accounting Sufficient expertise and resources did not exist, or were not appropriately applied, within the Registrant to accomplish an effective evaluation of the financial reporting for non-routine transactions (e.g., business combinations and dispositions), new accounting pronouncements, and significant accounting estimates (e.g., the allowance for loan losses). These deficiencies resulted in errors that were material, when aggregated, to the Registrant's preliminary 2006 financial statements. Reconciliation Function The policies and procedures over the design, preparation, and supervisory review of reconciliation and suspense monitoring functions (reconciliations) were deficient. Certain reconciliations were not designed effectively to detect misstatements. Other reconciliations were not performed in a timely manner or to a level of precision to detect material misstatements. In addition, the review function over reconciliations was not performed to a level of precision that would detect unusual variations or material misstatements. This deficiency resulted in a material error to mortgage services revenue within the Registrant's preliminary 2006 financial statements. During 2006, the Registrant acquired GBC Bancorp, Inc. Management excluded from its assessment of the effectiveness of the Registrant's internal control over financial reporting as of December 31, 2006, GBC Bancorp, Inc.'s internal control over financial reporting. GBC Bancorp, Inc. constituted 9.6 percent of the Registrant's consolidated total assets as of December 31, 2006, and 1.8 percent and 2.4 percent of the Registrant's consolidated total revenue and consolidated net income, respectively, for the year then ended. KPMG LLP, the Registrant's independent registered public accounting firm, audited the assessment performed by the Registrant's management with respect to the Registrant's internal control over financial reporting, as stated in their report which appears in this annual report on Form 10-K beginning on page 62.

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## **YARDVILLE NATIONAL BANCORP**

### **10-K 2006 Management - Internal Control Assessment**

One West Boylston Street  
Worcester, MA 01605  
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508.770.1120 (F)



## Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system is a process designed to provide reasonable assurance regarding the preparation of published financial statements in accordance with generally accepted accounting principles.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and provide reasonable assurance regarding prevention or timely detection of any unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control — Integrated Framework. Based on the assessment as of December 31, 2006 the Company did not maintain effective internal control over financial reporting due to existence of a material weakness related to the risk rating process and resultant determination of the allowance for loan losses and the provision for loan losses. Specifically, the following control deficiencies contributed to the material weakness:

- Ineffective policies and procedures related to the loan risk rating process by loan officers. Specifically, the Company's policies and procedures did not provide for effective updating of risk ratings on seasoned loans.
- Ineffective monitoring and review by credit risk review personnel to identify and resolve discrepancies in risk ratings on seasoned loans as compared to the Company's standard risk rating matrix.

As a result of the material weakness noted above, material misstatements were present in the Company's allowance for loan losses and provision for loan losses in the preliminary 2006 consolidated financial statements. Adjustments were recorded to correct such balances prior to the issuance of the 2006 consolidated financial statements.

The Company's independent registered public accounting firm that audited the consolidated financial statements has issued an audit report on management's assessment of our internal control over financial reporting as of December 31, 2006. This report appears on page 68.

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## **OCEANFIRST FINANCIAL CORP**

### **10-K 2006 Management - Internal Control Assessment**

#### Management Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal

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control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. The Company's internal control over financial reporting was designed to provide reasonable assurance regarding the preparation and fair presentation of published 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.

Management assessed the Company's internal control over financial reporting as of December 31, 2006. This assessment was based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2006 due to the existence of the following material weakness identified by management: The Company's policies and procedures were not effective to provide for the proper evaluation and assessment of the adequacy of its reserve for repurchased loans at its mortgage banking subsidiary. Specifically, the Company lacked an effective process to ensure that the exercise of loan repurchase requests by purchasers of its loans were timely identified and incorporated properly in the analysis of its reserve for repurchased loans. This deficiency resulted in material misstatements in the Company's reserve for repurchased loans and amounts recorded as a gain on sales of loans, and resulted in more than a remote likelihood that a material misstatement of the Company's annual or interim consolidated financial statements would not be prevented or detected. These misstatements have been corrected in the consolidated financial statements included elsewhere in this Form 10-K.

Table of Contents The Company's independent registered public accounting firm has issued an audit report on management's assessment of the Company's internal control over financial reporting. This report is included in Item 9A(d) below.

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## **GB&T BANCSHARES INC**

### **10-K 2006 Management - Internal Control Assessment**

#### Internal Control over Financial Reporting

The management of the Company and subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15f and 15d-15f. This internal control system has been designed to provide reasonable assurance to the Company's management and board of directors regarding the reliability of financial reporting and the preparation and fair presentation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

The management of the Company and subsidiaries has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. To make this assessment, we used the criteria for effective internal control over financial reporting described in Internal Control - Integrated Framework, issued by the Committee of Sponsoring

Organizations of the Treadway Commission. Based on our assessment and based on such criteria, we believe that, as of December 31, 2006, the Company's internal control over financial reporting was not effective, as demonstrated by a material weakness in the controls over loan approval, loan proceeds disbursement on construction and development loans, and problem loan reporting at HomeTown Bank of Villa Rica. The individuals charged with implementing these controls were either overridden or intimidated, thus rendering the controls ineffective.

Mauldin & Jenkins, LLC, the independent registered public accounting firm that audited the consolidated financial statements of the Company included in this Annual Report on Form 10-K, has issued an attestation report on management's assessment of the Company's internal control over financial reporting as of December 31, 2006. The report is included in this Item under the heading "Attestation Report of Independent Registered Public Accounting Firm."

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## **LNB BANCORP INC**

### **10-K 2006 Management - Internal Control Assessment**

#### Internal Control over Financial Reporting

The Management of LNB Bancorp, Inc. is responsible for establishing and maintaining adequate internal control over its financial reporting. LNB Bancorp, Inc.'s internal control over financial reporting is a process designed under the supervision of the Corporation's chief executive officer and chief financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

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.

LNB Bancorp, Inc.'s Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2006 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in "Internal Control Integrated Framework."

During the course of its audit, Plante & Moran PLLC advised management and the Audit and Finance Committee that it had identified control deficiencies, which when aggregated, constituted a material weakness in the Corporation's internal control over financial reporting. A material weakness is a significant deficiency, or a combination of significant deficiencies which when aggregated, results in there being more than a remote likelihood that a material misstatement of the annual or interim financials statements will not be prevented or detected on a timely basis by employees in the normal course of their assigned functions. As a result, Management concluded that the Corporation's internal control over financial reporting was not effective as of December 31, 2006 because of the material weakness described below. This material weakness did not result in an adjustment to the financial statements.

The material weakness identified resulted from the aggregation of significant deficiencies arising out of the lack of comprehensive procedural documentation of the loan grading

process, the system of monitoring the collateral values of impaired loans and the controls on preventing the improper recognition of interest income on nonperforming loans. Management, with the oversight of the Audit and Finance Committee, has been systematically addressing these issues and is committed to effective remediation of this weakness. The Corporation has taken the following remediation measures:

Additional training is being completed to reinforce the existing procedures to assure that adequate evidence exists to support all decisions made regarding classification of individual loans. Additional training is being completed to reinforce the requirement that once a loan meets the impairment criteria, such loans are deemed impaired and the impairment is valued based on a current appraisal of the collateral securing the loan. Training has been completed to reinforce the documentation requirements for the recognition of interest income once a loan is classified as nonperforming. Management has also revised the approval process for recording all nonperforming loan transactions. In addition to these specific responses to these control deficiencies, the Corporation has contracted with an independent third party to assess the completeness of the commercial loan documentation supporting the current grade classifications of all commercial relationships greater than \$500,000. This represents approximately 75 percent of the commercial loan portfolio balances.

Management has discussed these corrective actions with the Audit and Finance Committee and Plante & Moran, PLLC. Plante & Moran, PLLC has issued an attestation report on Management's assessment of the Corporation's internal control over financial reporting. That report appears on page 71 of this annual report on Form 10-K.

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## **NORTHERN STATES FINANCIAL CORP /DE/**

### **10-K 2006 Management - Internal Control Assessment**

#### Report on Management's Assessment of Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a - 15(f) and 15d - 15(f). The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chairman of the Board and President and Vice President and Treasurer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

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.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in "Internal Control-Integrated Framework". Based upon that assessment, the Company's management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2006, for the reasons described below.

During the course of its audit, Plante & Moran, PLLC, the Company's independent auditor,



advised management and the Audit Committee that it had identified a control deficiency that constituted a material weakness in the Company's internal control over financial reporting. A material weakness is a significant deficiency that results in there being more than a remote likelihood that a material misstatement of the annual or interim financials statements will not be prevented or detected on a timely basis by employees in the normal course of their assigned functions. The material weakness identified resulted from the improper recognition of ATM fee income due to a procedural bookkeeping error. The system of monitoring the ATM procedures was not effective in preventing the improper recognition of noninterest income. Based on that assessment, management concluded that the Company's internal control over financial reporting was not effective as of December 31, 2006 because of this material weakness.

Management, with the oversight of the Audit Committee, has addressed the issue and has taken steps to remediate the weakness. These remediation measures include changes to accounting procedures for the booking of ATM fee income as well as training of those persons monitoring and balancing the ATM procedures to insure that these errors do not reoccur. The identified error resulted in an overall pretax adjustment of \$664,000, of which \$238,000 impacted 2006 pretax earnings. The material weakness resulted in the Company's adoption of the SEC's Staff Accounting Bulletin No. 108 ("SAB 108") in which the cumulative misstatements were adjusted to the carrying values of assets and liabilities as of January 1, 2006, with an offsetting after tax adjustment to the beginning balance of retained earnings at January 1, 2006 equal to \$245,000.

Management has discussed these corrective actions with the Audit Committee and Plante & Moran, PLLC. Plante & Moran, PLLC has issued an opinion on management's assessment of the Company's internal control over financial reporting as of December 31, 2006. That report appears on page 17 of this report on Form 10-K.

/s/ Fred Abdula

/s/ Thomas M. Nemeth

Fred Abdula

Thomas M. Nemeth

Chairman of the Board & President

Vice President & Treasurer

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