DOUGLAS KEVIN
Form SC 13G/A
May 05, 2010

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

SCHEDULE 13G

Under the Securities Exchange Act of 1934
(Amendment No. 2)*

Westport Innovations Inc.
(Name of Issuer)
Common Stock
(Title of Class of Securities)
960908309
(CUSIP Number)
James R. Black
Davis Wright Tremaine
505 Montgomery Street, Suite 800
San Francisco, CA 94111
(415) 276-6508
(Name, Address and Telephone Number of Person Authorized to Receive Notices and Communications)
May 3, 2010
(Date of Event Which Requires Filing of this Statement)

Check the appropriate box to designate the rule pursuant to which this Schedule is filed:

o Rule 13d-1(b)

þ Rule 13d-1(c)

o Rule 13d-1(d)

* The remainder of this cover page shall be filled out for a reporting person s initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter the disclosures provided in a prior cover page.

The information required in the remainder of this cover page shall not be deemed to be filed for the purpose of Section 18 of the Securities Exchange Act of 1934 (Act) or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

CUSIP No. 960908309

1	NAMES OF REPORTING PERSONS I.R.S. Identification Nos. of above persons (entities only) Kevin Douglas
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (SEE INSTRUCTIONS) (a) o (b) þ
3	SEC USE ONLY
4	CITIZENSHIP OR PLACE OF ORGANIZATION United States

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:	**5**	SOLE VOTING POWER -0-
	6	SHARED VOTING POWER 5,092,530 (1)
	7	SOLE DISPOSITIVE POWER -0-
	8	SHARED DISPOSITIVE POWER 6,976,067 (1)(2)

9	AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 6,976,067 (1)(2)

10	CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES (SEE INSTRUCTIONS) o
11	PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9) 17.7% (3)
12	TYPE OF REPORTING PERSON (SEE INSTRUCTIONS) IN

(1) Kevin Douglas and his wife, Michelle Douglas, hold 2,790,431 shares jointly as the beneficiaries and co-trustees of the K&M Douglas Trust. In addition, Kevin Douglas and Michelle Douglas are co-trustees of the James Douglas and Jean Douglas Irrevocable Descendants Trust, which holds 2,302,099 shares.
(2) Kevin Douglas has dispositive power with respect to 697,608 shares held by James E. Douglas III and 1,185,929 shares held by the Douglas Family Trust.
(3) Based on 39,325,853 shares of the Issuer s common stock outstanding as of April 14, 2010, as reported on the press release included as an exhibit to Issuer s Form 6-K filed with the SEC on April 15, 2010.

CUSIP No. 960908309

1	NAMES OF REPORTING PERSONS I.R.S. Identification Nos. of above persons (entities only) Michelle Douglas
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (SEE INSTRUCTIONS) (a) o (b) þ
3	SEC USE ONLY
4	CITIZENSHIP OR PLACE OF ORGANIZATION United States

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:	**5**	SOLE VOTING POWER -0-
	6	SHARED VOTING POWER 5,092,530 (1)
	7	SOLE DISPOSITIVE POWER -0-
	8	SHARED DISPOSITIVE POWER 5,092,530 (1)

9	AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 5,092,530 (1)

10	CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES (SEE INSTRUCTIONS) o
11	PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9) 12.9%(2)
12	TYPE OF REPORTING PERSON (SEE INSTRUCTIONS) IN

(1) Kevin Douglas and his wife, Michelle Douglas, hold 2,790,431 shares jointly as the beneficiaries and co-trustees of the K&M Douglas Trust. In addition, Kevin Douglas and Michelle Douglas are co-trustees of the James Douglas and Jean Douglas Irrevocable Descendants Trust, which holds 2,302,099 shares.
(2) Based on 39,325,853 shares of the Issuer s common stock outstanding as of April 14, 2010, as reported on the press release included as an exhibit to Issuer s Form 6-K filed with the SEC on April 15, 2010.

CUSIP No. 960908309

1	NAMES OF REPORTING PERSONS I.R.S. Identification Nos. of above persons (entities only) James E. Douglas III
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (SEE INSTRUCTIONS) (a) o (b) þ
3	SEC USE ONLY
4	CITIZENSHIP OR PLACE OF ORGANIZATION United States

NUMBER OF	**5**	SOLE VOTING POWER 697,608
SHARES BENEFICIALLY OWNED BY	**6**	SHARED VOTING POWER -0-
EACH REPORTING PERSON	**7**	SOLE DISPOSITIVE POWER -0-
WITH:	**8**	SHARED DISPOSITIVE POWER 697,608 (1)

9	AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 697,608 (1)

10	CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES (SEE INSTRUCTIONS) o
11	PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9) 1.8%(2)
12	TYPE OF REPORTING PERSON (SEE INSTRUCTIONS) IN

(1) Kevin Douglas has dispositive power with respect to 697,608 shares held by James E. Douglas III.
(2) Based on 39,325,853 shares of the Issuer s common stock outstanding as of April 14, 2010, as reported on the press release included as an exhibit to Issuer s Form 6-K filed with the SEC on April 15, 2010.

CUSIP No. 960908309

1	NAMES OF REPORTING PERSONS I.R.S. Identification Nos. of above persons (entities only) K&M Douglas Trust (1)
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (SEE INSTRUCTIONS) (a) o (b) þ
3	SEC USE ONLY
4	CITIZENSHIP OR PLACE OF ORGANIZATION California

NUMBER OF	**5**	SOLE VOTING POWER -0-
SHARES BENEFICIALLY OWNED BY	**6**	SHARED VOTING POWER 2,790,431 (2)
EACH REPORTING PERSON	**7**	SOLE DISPOSITIVE POWER -0-
WITH:	**8**	SHARED DISPOSITIVE POWER 2,790,431 (2)

9	AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 2,790,431 (2)

10	CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES (SEE INSTRUCTIONS) o
11	PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9) 7.1%(3)
12	TYPE OF REPORTING PERSON (SEE INSTRUCTIONS) OO

(1) Kevin Douglas and Michelle Douglas, husband and wife, are beneficiaries and co-trustees.
(2) Kevin Douglas and his wife, Michelle Douglas, hold 2,790,431 shares jointly as the beneficiaries of the K&M Douglas Trust.
(3) Based on 39,325,853 shares of the Issuer s common stock outstanding as of April 14, 2010, as reported on the press release included as an exhibit to Issuer s Form 6-K filed with the SEC on April 15, 2010.

CUSIP No. 960908309

1	NAMES OF REPORTING PERSONS I.R.S. Identification Nos. of above persons (entities only) Douglas Family Trust (1)		
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (SEE INSTRUCTIONS) (a) o (b) þ		
3	SEC USE ONLY		
4	CITIZENSHIP OR PLACE OF ORGANIZATION California		
NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:	**5**	SOLE VOTING POWER 1,185,929	
	6	SHARED VOTING POWER -0-	
	7	SOLE DISPOSITIVE POWER -0-	
	8	SHARED DISPOSITIVE POWER 1,185,929 (2)	
9	AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 1,185,929 (2)		

10	CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES (SEE INSTRUCTIONS) o
11	PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9) 3.0%(3)
12	TYPE OF REPORTING PERSON (SEE INSTRUCTIONS) OO

(1) James E. Douglas, Jr. and Jean A. Douglas, husband and wife, are co trustees.
(2) Kevin Douglas has dispositive power with respect to 1,185,929 shares held by the Douglas Family Trust.
(3) Based on 39,325,853 shares of the Issuer s common stock outstanding as of April 14, 2010, as reported on the press release included as an exhibit to Issuer s Form 6-K filed with the SEC on April 15, 2010.

CUSIP No. 960908309

1	NAMES OF REPORTING PERSONS I.R.S. Identification Nos. of above persons (entities only) James Douglas and Jean Douglas Irrevocable Descendants' Trust (1)		
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (SEE INSTRUCTIONS) (a) o (b) þ		
3	SEC USE ONLY		
4	CITIZENSHIP OR PLACE OF ORGANIZATION California		
NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:	**5**	SOLE VOTING POWER 2,302,099	
	6	SHARED VOTING POWER -0-	
	7	SOLE DISPOSITIVE POWER 2,302,099	
	8	SHARED DISPOSITIVE POWER -0-	
9	AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 2,302,099		

10	CHECK IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES (SEE INSTRUCTIONS) o
11	PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW (9) 5.9%(2)
12	TYPE OF REPORTING PERSON (SEE INSTRUCTIONS) OO

(1) Kevin Douglas and Michelle Douglas, husband and wife, are co trustees.
(2) Based on 39,325,853 shares of the Issuer s common stock outstanding as of April 14, 2010, as reported on the press release included as an exhibit to Issuer s Form 6-K filed with the SEC on April 15, 2010.

CUSIP No. 960908309

Item 1.

(a) Name of Issuer:
Westport Innovations Inc.

(b) Address of Issuer s Principal Executive Offices:
Suite 101
1750 West 75th Avenue
Vancouver, British Columbia
Canada
V6P 6G2

Item 2.

(1)(a) NAME OF PERSONS FILING:
Kevin Douglas
Michelle Douglas
James E. Douglas III

(b) ADDRESS OF PRINCIPAL BUSINESS OFFICE OR, IF NONE, RESIDENCE:
125 E. Sir Francis Drake Blvd., Ste 400
Larkspur, CA 94939

(c) CITIZENSHIP:
United States

(d) TITLE OF CLASS OF SECURITIES:
Common Stock, par value $1 per share

(e) CUSIP NUMBER:
960908309

(2)(a) NAME OF PERSONS FILING:
K&M Douglas Trust
Douglas Family Trust
James Douglas and Jean Douglas Irrevocable Descendants Trust

(b) ADDRESS OF PRINCIPAL BUSINESS OFFICE OR, IF NONE, RESIDENCE:
125 E. Sir Francis Drake Blvd., Ste 400
Larkspur, CA 94939

(c) CITIZENSHIP:
California

(d) TITLE OF CLASS OF SECURITIES:
Common Stock

CUSIP No. 960908309

(e) CUSIP NUMBER:
960908309

Item 3. If this statement is filed pursuant to Rule 13d-1(b) or 13d-2(b) or (c), check whether the person filing is a:

(a) o Broker or dealer registered under section 15 of the Act (15 U.S.C. 78o).

(b) o Bank as defined in section 3(a)(6) of the Act (15 U.S.C. 78c).

(c) o Insurance company as defined in section 3(a)(19) of the Act (15 U.S.C. 78c).

(d) o Investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8)

(e) o An investment adviser in accordance with §240.13d-1(b)(1)(ii)(E);

(f) o An employee benefit plan or endowment fund in accordance with §240.13d-1(b)(1)(ii)(F);

(g) o A parent holding company or control person in accordance with §240.13d-1(b)(1)(ii)(G);

(h) o A savings association as defined in Section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(i) o A church plan that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 (15 U.S.C. 80a-3);

(j) o Group, in accordance with §240.13d-1(b)(1)(ii)(J)

Not Applicable.

CUSIP No. 960908309

Item 4. Ownership

Reference is made as to each of the Reporting Persons hereunder to Rows 5-9 and 11 of each of the cover pages of this Schedule 13G/A and associated footnotes, which are incorporated by reference herein.

Each of the Reporting Persons hereunder may be deemed a member of a group within the meaning of Section 13(d)(3) of the Securities Exchange Act of 1934 (the Exchange Act), or Rule 13d-5 promulgated under the Exchange Act with one or more of the other Reporting Persons hereunder. Although the Reporting Persons are reporting such securities as if they were members of a group, the filing of this Schedule 13G/A shall not be construed as an admission by any Reporting Person that such Reporting Person is a beneficial owner of any securities other than those directly held by such Reporting Person.

Item 5. Ownership of Five Percent or Less of a Class

If this statement is being filed to report the fact that as of the date hereof the reporting person has ceased to be the beneficial owner of more than five percent of the class of securities, check the following: o

Item 6. Ownership of More Than Five Percent on Behalf of Another Person

Not applicable.

Item 7. Identification and Classification of the Subsidiary Which Acquired the Security Being Reported on by the Parent Holding Company

Not applicable.

Item 8. Identification and Classification of Members of the Group

See Item 4 of this Schedule 13G/A and the Joint Filing Agreement attached hereto as Exhibit A.

Item 9. Notice of Dissolution of Group

Not applicable.

Item 10. Certification

By signing below I certify that, to the best of my knowledge and belief, the securities referred to above were not acquired and are not held for the purpose of or with the effect of changing or influencing the control of the Issuer of the securities and were not acquired and are not held in connection with or as a participant in any transaction having that purpose or effect.

CUSIP No. 960908309

SIGNATURE

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Date: May 4, 2010	* Kevin Douglas Kevin Douglas
Date: May 4, 2010	* Michelle Douglas Michelle Douglas
Date: May 4, 2010	* James E. Douglas III James E. Douglas III
	K&M Douglas Trust
Date: May 4, 2010	* Kevin Douglas By: Kevin Douglas Title: Trustee
Date: May 4, 2010	* Michelle Douglas By: Michelle Douglas Title: Trustee
	Douglas Family Trust
Date: May 4, 2010	* James E. Douglas, Jr. By: James E. Douglas, Jr. Title: Trustee
Date: May 4, 2010	* Jean A. Douglas By: Jean A. Douglas Title: Trustee
	James Douglas And Jean Douglas Irrevocable Descendants Trust
Date: May 4, 2010	* Kevin Douglas By: Kevin Douglas Title: Trustee
Date: May 4, 2010	* Michelle Douglas By: Michelle Douglas Title: Trustee

CUSIP No. 960908309

*By: /s/ Tim McGaw
Tim McGaw
Attorney-in-fact

CUSIP No. 960908309

EXHIBIT A
JOINT FILING AGREEMENT

This Joint Filing Agreement (this Agreement) hereby confirms the agreement by and among all of the undersigned that the Schedule 13G/A to which this Agreement is attached as Exhibit A with respect to the beneficial ownership of the undersigned of shares Common Stock of Westport Innovations Inc. is being filed on behalf of each of the undersigned. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

Date: May 4, 2010	* Kevin Douglas Kevin Douglas
Date: May 4, 2010	*Michelle Douglas Michelle Douglas
Date: May 4, 2010	* James E. Douglas III James E. Douglas III
	K&M Douglas Trust
Date: May 4, 2010	* Kevin Douglas By: Kevin Douglas Title: Trustee
Date: May 4, 2010	* Michelle Douglas By: Michelle Douglas Title: Trustee
	Douglas Family Trust
Date: May 4, 2010	* James E. Douglas, Jr. By: James E. Douglas, Jr. Title: Trustee
Date: May 4, 2010	* Jean A. Douglas By: Jean A. Douglas Title: Trustee
	James Douglas And Jean Douglas Irrevocable Descendants Trust
Date: May 4, 2010	* Kevin Douglas By: Kevin Douglas Title: Trustee

CUSIP No. 960908309

Date: May 4, 2010

* Michelle Douglas
By: Michelle Douglas
Title: Trustee

*By: /s/ Tim McGaw
Tim McGaw
Attorney-in-fact

llion, respectively, and an allowance for loan losses of $2.93 million, $2.59 million, and $2.32 million, respectively. From time to time, the Bank may originate residential mortgage loans, sell them on the secondary market, normally recognizing fee income in connection with the sale. Interest rates on loans are affected by the demand for loans, the supply of money available for lending, credit risks, the rates offered by competitors and other conditions. These factors are in turn affected by, among other things, economic conditions, monetary policies of the federal government, and legislative tax policies. In order to manage interest rate risk, the Bank focuses its efforts on loans with interest rates that adjust based upon changes in the prime rate or changes in United States Treasury or similar indices. Generally, credit risks on adjustable-rate loans are somewhat greater than on fixed-rate loans primarily because, as interest rates rise, so do borrowers' payments, increasing the potential for default. The Bank seeks to impose appropriate loan underwriting standards in order to protect against these and other credit related risks associated with its lending operations. In addition to analyzing the income and assets of its borrowers when underwriting a loan, the Bank obtains independent appraisals on all material real estate in which the Bank takes a mortgage. The Bank generally obtains title insurance in order to protect against title defects on mortgaged property. Commercial and Mortgage Loans. The Bank originates commercial mortgage loans secured by office buildings, retail establishments, multi-family residential real estate and other types of commercial property. Substantially all of the properties are located in the New York City metropolitan area. The Bank generally makes commercial mortgage loans with loan to value ratios not to exceed 75% and with terms to maturity that do not exceed 15 years. Loans secured by commercial properties generally involve a greater degree of risk than one- to four-family residential mortgage loans. Because payments on such loans are often dependent on successful operation or management of the properties, repayment may be subject, to a greater extent, to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks through its underwriting policies. The Bank evaluates the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the underlying property. The factors considered by the Bank include net operating income; the debt coverage ratio (the ratio of cash net income to debt service); and the loan to value ratio. When evaluating the borrower, the Bank considers the financial resources and income level of the borrower, the borrower's experience in owning or managing similar property and the Bank's lending experience with the borrower. The Bank's policy requires borrowers to present evidence of the ability to repay the loan without having to resort to the sale of the mortgaged property. The Bank also seeks to focus its commercial mortgage loans on loans to companies with operating businesses, rather than passive real estate investors. Commercial Loans. The Bank makes commercial loans to businesses for inventory financing, working capital, machinery and equipment purchases, expansion, and other business purposes. These loans generally have higher yields than mortgages loans, with maturities of one year, after which the borrower's financial condition and the terms of the loan are re-evaluated. Commercial loans tend to present greater risks than mortgage loans because the collateral, if any, tends to be rapidly depreciable, difficult to sell at full value and is often easier to conceal. In order to limit these risks, the Bank evaluates these loans based upon the borrower's ability to repay the loan 26 from ongoing operations. The Bank considers the business history of the borrower and perceived stability of the business as important factors when considering applications for such loans. Occasionally, the borrower provides commercial or residential real estate collateral for such loans, in which case the value of the collateral may be a significant factor in the loan approval process. Residential Mortgage Loans (1 to 4 family loans). The Bank makes residential mortgage loans secured by first liens on one-to-four family owner- occupied or rental residential real estate. At December 31, 2004 and 2003, approximately $151.20 million and $169.59 million, respectively, or 52.69% and 57.4%, respectively, of the Company's total loan portfolio consisted of such loans. The Company offers both adjustable rate mortgages ("ARMS") and fixed-rate mortgage loans. The relative proportion of fixed-rate loans versus ARMs originated by the Bank depends principally upon current customer preference, which is generally driven by economic and interest rate conditions and the pricing offered by the Bank's competitors. At December 31, 2004 and 2003, approximately 13% and 12%, respectively, of the Bank's residential one-to-four family owner-occupied first mortgage portfolio were ARMs and approximately 87% and 88%, respectively, were fixed-rate loans. The percentage represented by fixed-rate loans tends to increase during periods of low interest rates. The ARMs generally carry annual caps and life-of-loan ceilings, which limit interest rate adjustments. The Bank's residential loan underwriting criteria are generally comparable to those required by the Federal National Mortgage Association ("FNMA") and other major secondary market loan purchasers. Generally, ARM credit risks are somewhat greater than fixed-rate loans primarily because, as interest rates rise, the borrowers' payments rise, increasing the potential for default. The Bank's teaser rate ARMs (ARMs with low initial interest rates that are not based upon the index plus the margin for determining future rate adjustments) were underwritten based on the payment due at the fully-indexed rate. In addition to verifying income and assets of borrowers, the Bank obtains independent appraisals on all residential first mortgage loans and title insurance is required at closing. Private mortgage insurance is required on all loans with a loan-to-value ratio in excess of 80% and the Bank requires real estate tax escrows on such loans. Real estate tax escrows are voluntary on residential mortgage loans with loan-to-value ratios of 80% or less. Fixed-rate residential mortgage loans are generally originated by the Bank for terms of 15 to 30 years. Although 30 year fixed-rate mortgage loans may adversely affect our net interest income in periods of rising interest rates, the Bank originates such loans to satisfy customer demand. Such loans are generally originated at initial interest rates which exceed the fully indexed rate on ARMs offered at the same time. Fixed-rate residential mortgage loans originated by the Bank generally include due-on-sale clauses, which permit the Bank to demand payment in full if the borrower sells the property without the Bank's consent. Due-on-sale clauses are an important means of adjusting the rates on the Bank's fixed-rate mortgage loan portfolio, and the Bank will generally exercise its rights under these clauses if necessary to maintain market yields. ARMs originated in recent years have interest rates that adjust annually based upon the movement of the one year treasury bill constant maturity index, plus a margin of 2.00% to 2.75%. These loans generally have a maximum interest rate adjustment of 2% per year, with a lifetime maximum interest rate adjustment, measured from the initial interest rate, of 5.5% or 6.0%. The Bank offers a variety of other loan products including residential single family construction loans to persons who intend to occupy the property upon completion of construction, home equity loans secured by junior mortgages on one-to-four family owner-occupied residences, and short-term fixed-rate consumer loans either unsecured or secured by monetary assets such as bank deposits and marketable securities or personal property. Origination of Loans. Loan originations can be attributed to depositors, retail customers, phone inquiries, advertising, the efforts of the Bank's loan officers, and referrals from other borrowers, real estate brokers and builders. The Bank originates loans primarily through its own efforts, occasionally obtaining loan opportunities as a result of referrals from loan brokers. 27 At December 31, 2004, the Bank's total capital, net of goodwill and loan loss reserves, was approximately $82.97 million and thus it was generally not permitted to make loans to one borrower in excess of approximately $12.4 million, with an additional amount of approximately $8.3 million being permitted if secured by readily marketable collateral. The Bank was also not permitted to make any single mortgage loan in an amount in excess of approximately $12.4 million. At December 31, 2004, the Bank was in compliance with these standards. Delinquency Procedures. When a borrower fails to make a required payment on a loan, the Bank attempts to cause the deficiency to be cured by contacting the borrower. The Bank reviews past due loans on a case by case basis, taking the action it deems appropriate in order to collect the amount owed. Litigation may be necessary if other procedures are not successful. Judicial resolution of a past due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Bank first obtains relief from the automatic stay provided by the Bankruptcy Code. If a non-mortgage loan becomes delinquent and satisfactory arrangements for payment cannot be made, the Bank seeks to realize upon any personal property collateral to the extent feasible and collect any remaining amount owed from the borrower through legal proceedings, if necessary. It is the Bank's policy to discontinue accruing interest on a loan when it is 90 days past due or if management believes that continued interest accruals are unjustified. The Bank may continue interest accruals if a loan is more than 90 days past due if the Bank determines that the nature of the delinquency and the collateral are such that collection of the principal and interest on the loan in full is reasonably assured. When the accrual of interest is discontinued, all accrued but unpaid interest is charged against current period income. Once the accrual of interest is discontinued, the Bank records interest as and when received until the loan is restored to accruing status. If the Bank determines that collection of the loan in full is in reasonable doubt, then amounts received are recorded as a reduction of principal until the loan is returned to accruing status. The following tables set forth information concerning the Company's loan portfolio by type of loan at the dates indicated: December 31, --- 2004 2003 2002 -------------------------- ----------------------- ---------------------------- % of % of % of Amount Total Amount Total Amount Total ------------- ---------- ---------- --------- ---------------- --------- (Dollars in thousands) Commercial and professional loans $ 16,498 5.7 % $ 22,228 7.5 % $ 16,704 6.0 % Secured by real estate 1 - 4 family 155,079 53.9 169,589 57.4 180,730 65.4 Multi family 4,600 1.6 6,608 2.2 8,958 3.2 Non-residential (commercial) 109,597 38.1 94,956 32.2 65,809 23.8 Consumer 1,989 0.7 2,239 0.7 4,051 1.6 ------- ----- ------- ----- ------- ----- Total loans 287,763 100.0 % 295,620 100.0 % 276,252 100.0 % ===== ===== ===== Less: Allowance for loan losses (2,927) (2,593) (2,315) Unearned fees (784) (864) (755) -------- -------- -------- Loans, net $284,052 $292,163 $273,182 ======== ======== ======== 28 December 31, 2001 December 31, 2000 ---------------------- ------------------------ % of % of Amount Total Amount Total ------ ----- ------ ----- (Dollars in thousands) Commercial and professional loans $ 19,130 7.6% $ 9,419 12.5% Secured by real estate 1 - 4 family 165,195 65.5 25,677 34.0 Multi family 11,186 4.4 4,765 6.3 Non-residential (commercial) 51,893 20.6 34,968 46.2 Consumer 4,689 1.8 229 0.3 Other 140 0.1 565 0.7 -------- ----- -------- Total loans 252,233 100.0% 75,623 100.0% ===== ===== Less: Allowance for loan losses (2,030) (1,108) Unearned fees (193) (275) -------- -------- Loans, net $250,010 $ 74,240 ======== ======== Impaired loan balance, nonaccrual loans and loans greater than 90 days still accruing The following table sets forth certain information regarding nonaccrual loans, including the ratio of such loans to total assets as of the dates indicated, and certain other related information. The Bank had no foreclosed real estate during these periods and loans past due more than 90 days still accruing were $50,000 and $0 at December 31, 2004 and 2003, respectively. December 31, --- 2004 2003 2002 2001 2000 ---- ---- ---- ---- (Dollars in Thousands) Nonaccrual loans: Commercial and $ -- $ -- $ -- $ 9 $ -- professional loans Consumer 1 -- -- -- -- Secured by real estate 342 109 59 -- -- ------ ------ ------ ------ ------ Total nonaccrual loans 343 109 59 9 -- ------ ------ ------ ------ ------ Accruing loans delinquent 90 days or more 50 -- -- -- -- Total nonperforming loans $ 393 $ 109 $ 59 $ 9 $ -- ====== ====== ====== ====== ====== Total nonperforming loans to total assets .04% .01% -- -- -- ====== ====== ====== ====== ====== The following tables present information regarding the Company's total allowance for loan losses as well as the allocation of such amounts to the various categories of loans at the dates indicated (dollars in thousands): December 31, 2004 --- Allowance for Loan Percent of Percent of Losses Allowance Total Loans --------------- --------------- ---------------- Commercial and professional loans $ 223 7.6% 0.08% Secured by real estate 1 - 4 family 775 26.5 0.27 Multi family 62 2.1 0.02 Non-residential 1,398 47.8 0.49 Consumer and other 27 0.9 0.01 General allowance (1) 442 15.1 0.15 ------- ----- ---- Total allowance for loan losses $ 2,927 100.0% 1.02% ======= ===== ==== ---------- (1) The allowance for loan losses is allocated to specific loans as necessary. 29 December 31, 2003 --- Allowance for Loan Percent of Percent of Losses Allowance Total Loans --------------- --------------- ---------------- Commercial and professional loans $ 300 11.6% 0.10% Secured by real estate 1 - 4 family 424 16.3 0.14 Multi family 89 3.4 0.03 Non-residential 1,198 46.2 0.41 Consumer and other 30 1.2 0.01 General allowance (1) 552 21.3 0.19 ------- ----- ---- Total allowance for loan losses $ 2,593 100.0% 0.88% ======= ===== ==== ---------- (1) The allowance for loan losses is allocated to specific loans as necessary. December 31, 2002 --- Allowance for Loan Percent of Percent of Losses Allowance Total Loans --------------- --------------- ---------------- Commercial and professional loans $ 225 9.7% 0.08% Secured by real estate 1 - 4 family 452 19.5 0.16 Multi family 121 5.2 0.04 Non-residential 888 38.4 0.32 Consumer and other 55 2.4 0.02 General allowance (1) 574 24.8 0.21

------- ----- ---- Total allowance for loan losses $ 2,315 100.0% 0.83% ======= ===== ==== ---------- (1) The allowance for loan losses is allocated to specific loans as necessary. December 31, 2002 --- Allowance for Loan Percent of Percent of Losses Allowance Total Loans --------------- --------------- ----------------- Commercial and professional loans $ 188 9.3% 0.07% Secured by real estate 1 - 4 family 804 39.6 0.32 Multi family 84 4.1 0.03 Non-residential 790 38.9 0.32 Consumer and other 24 1.2 0.06 General allowance (1) 140 6.9 0.06 ------- ----- ---- Total allowance for loan losses $ 2,030 100.0% 0.79% ======= ===== ==== ---------- (1) The allowance for loan losses is allocated to specific loans as necessary. 30 December 31, 2002 --- Allowance for Loan Percent of Percent of Losses Allowance Total Loans --------------- --------------- ----------------- Commercial and professional loans $ 89 8.0% 0.12% Secured by real estate 654 59.0 0.86 Personal and other 13 1.2 0.02 General allowance (1) 352 31.8 0.47% ------- ----- ---- Total allowance for loan losses $ 1,108 100.0% 1.47% ======= ===== ==== ---------- (1) The allowance for loan losses is allocated to specific loans as necessary. The following tables set forth information regarding the aggregate maturities of the Company's loans in the specified categories and the amount of such loans which have fixed and variable rates. December 31, 2002 --- Within 1 to After 1 Year 5 Years 5 Years Total -------- --------- --------- ------ (In thousands) Fixed Rate Commercial and professional $ 657 $ 3,961 $ 128,193 $ 132,811 Non-residential 5,453 31,755 30,885 68,093 --------- --------- --------- --------- Total fixed rate $ 6,110 $ 35,716 $ 159,078 $ 200,904 --------- --------- --------- --------- Adjustable Rate Commercial and professional 1,407 10,459 15,002 26,868 Non-residential 25,396 11,298 23,297 59,991 --------- --------- --------- --------- Total adjustable rate $ 26,803 $ 21,757 $ 38,299 $ 86,859 --------- --------- --------- --------- Total $ 32,913 $ 57,473 $ 197,377 $ 287,763 ========= ========= ========= ========= 31 The following table sets forth information with respect to activity in the Company's allowance for loan losses during the periods indicated (in thousands, except percentages): Years Ended December 31, -- 2004 2003 2002 2001 2000 ---- ---- ---- ---- ---- Average loans outstanding $290,774 $291,586 $265,961 $195,296 $ 70,357 ======== ======== ======== ======== ======== Allowance at beginning of period 2,593 2,315 2,030 1,108 923 Charge-offs: Commercial and other loans 24 4 199 97 -- Real estate loans -- 13 -- -- -- -------- -------- -------- -------- -------- Total loans charged-off 24 17 199 97 -- -------- -------- -------- -------- -------- Recoveries: Commercial and other loans 178 55 97 41 130 Real estate loans -- -- -- -- -- -------- -------- -------- -------- -------- Total loans recovered 178 55 97 41 130 -------- -------- -------- -------- -------- Net recoveries (charge-offs) 154 38 (102) (56) 130 -------- -------- -------- -------- -------- Provision for loan losses charged to operating expenses 180 240 387 287 55 Acquisition of GSB -- -- -- 691 -- -------- -------- -------- -------- -------- Allowance at end of period $ 2,927 $ 2,593 $ 2,315 $ 2,030 $ 1,108 -------- -------- -------- -------- -------- Ratio of net recoveries (charge-offs) to average loans outstanding .05% 0.01% (.03)% (.02)% .18% ======== ======== ======== ======== ======== Allowance as a percent of total loans 1.02% 0.88% 0.83% 0.80% 1.47% ======== ======== ======== ======== ======== Total loans at end of period $287,763 $295,620 $276,252 $252,233 $ 75,623 ======== ======== ======== ======== ======== Deposits The Bank concentrates on obtaining deposits from a variety of businesses, professionals and retail customers. The Bank offers a number of different deposit programs, including statement savings accounts, NOW accounts, money market deposits accounts, checking accounts and certificates of deposits with terms from seven days to five years. Deposit account terms vary according to the minimum balance required, the time period the funds must remain on deposit and the interest rate, among other factors. The Bank prices its deposit offerings competitively within the market it serves. These products are designed to attract new customers, retain existing customers and create opportunities to offer other bank products or services. While the market and pricing for deposit funds are very competitive, the Bank believes that personalized, quality service is also an important element in retaining core deposit customers. 32 The following table summarizes the composition of the average balances of major deposit categories: December 31, --- 2004 2003 2002 ---- ---- ---- Average Average Average Average Average Average Amount Yield Amount Yield Amount Yield ------ ----- ------ ----- ------ ----- (Dollars in thousands) Demand deposits $ 38,896 -- $ 32,592 -- $ 30,102 -- NOW and money market 47,677 0.65% 58,723 1.02% 60,114 1.28% Savings deposits 224,542 1.55 143,094 1.95 56,217 1.56 Time deposits 309,968 1.94 333,112 2.26 273,452 3.21 -------- ---- -------- ---- -------- ---- Total deposits $621,083 1.58% $567,521 1.78% $419,885 2.48% ======== ==== ======== ==== ======== ==== The aggregate amount of jumbo certificates of deposit, each with a minimum denomination of $100,000, was approximately $109.74 million, $110.08 million and

$108.72 million December 31, 2004, 2003 and 2002, respectively. The following table summarizes the maturity distribution of time deposits of $100,000 or more as of December 31, 2004: (In thousands) 3 months or less $ 48,987 Over 3 months but within 6 months 25,160 Over 6 months but within 12 months 10,375 Over 12 months 25,219 -------- Total $109,741 ======== Short-Term Borrowings Securities sold under agreements to repurchase generally mature within 30 days from the date of the transactions. Short-term borrowings consist of Treasury Tax and Loan Note Options and various other borrowings which generally have maturities of less than one year. The details of these categories are presented below: Years Ended December 31, -- 2004 2003 2002 -------------- --------------- -------------- (Dollars in thousands) Securities sold under repurchase agreements and federal funds purchased Balance at year-end $127,747 $114,391 $ 46,673 Average during the year $129,794 $ 57,554 $ 38,443 Maximum month-end balance $148,753 $114,391 $ 47,407 Weighted average rate during the year 1.87% 1.68% 1.79% Rate at December 31 2.27% 1.73% 1.46% 33 Capital Resources and Liquidity Liquidity The management of the Company's liquidity focuses on ensuring that sufficient funds are available to meet loan funding commitments, withdrawals from deposit accounts, the repayment of borrowed funds, and ensuring that the Bank and the Company comply with regulatory liquidity requirements. Liquidity needs of The Berkshire Bank have historically been met by deposits, investments in federal funds sold, principal and interest payments on loans, and maturities of investment securities. For the parent company, Berkshire Bancorp Inc., liquidity means having cash available to fund operating expenses and to pay shareholder dividends, when and if declared by our Board of Directors. We paid cash dividends per share of $.11, $.08 and $.07 in fiscal 2004, 2003 and 2002, respectively. The ability to fund our operations and to pay dividends is not dependent upon the receipt of dividends from The Berkshire Bank. At December 31, 2004, we had cash of approximately $7.4 million and investment securities with a fair market value of $9.0 million. Contingent Liabilities and Commitments The Bank maintains financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and stand-by letters of credit. The following table presents the Company's commitments at December 31, 2004. Expiration By Period -- Less More Than 1-3 3-5 Than Total 1 Year Years Years 5 Years ----- ------ ----- ----- ------- (In thousands) Lines of Credit $ 15,859 $ 9,555 $ 3,730 $ 958 $ 1,616 Standby Letters of Credit 750 706 44 -- -- Loan Commitments -- -- -- -- -- Total $ 16,609 $ 10,261 $ 3,774 $ 958 $ 1,616 ======== ======== ======== ======== ======== Contractual Obligations The following table presents the Company's contractual obligations at December 31, 2004. Payments Due By Periods -- Less More Than 1-3 3-5 Than Total 1 Year Years Years 5 Years ----- ------ ----- ----- ------- (In thousands) Long-Term Debt $ 95,605 $ 2,638 $ 43,296 $ 35,671 $ 14,000 Operating Leases 3,695 712 1,440 1,012 531 Time Deposits 274,309 218,691 53,538 2,080 -- -------- -------- -------- -------- -------- Total Contractual Obligations $373,609 $222,041 $ 98,274 $ 38,763 $ 14,531 ======== ======== ======== ======== ======== The Company currently has one unconsolidated subsidiary and no special purpose entities. 34 Capital The capital ratios of the Bank and Berkshire are presently in excess of the requirements necessary to meet the "well capitalized" capital category established by bank regulators. See Note P to the Consolidated Financial Statements. Interest Rate Risk Fluctuations in market interest rates can have a material effect on the Bank's net interest income because the yields earned on loans and investments may not adjust to market rates of interest with the same frequency, or with the same speed, as the rates paid by the Bank on its deposits. Most of the Bank's deposits are either interest-bearing demand deposits or short term certificates of deposit and other interest-bearing deposits with interest rates that fluctuate as market rates change. Management of the Bank seeks to reduce the risk of interest rate fluctuations by concentrating on loans and securities investments with either short terms to maturity or with adjustable rates or other features that cause yields to adjust based upon interest rate fluctuations. In addition, to cushion itself against the potential adverse effects of a substantial and sustained increase in market interest rates, the Bank has purchased off balance sheet interest rate cap contracts which generally provide that the Bank will be entitled to receive payments from the other party to the contract if interest rates exceed specified levels. These contracts are entered into with major financial institutions. The Company seeks to maximize its net interest margin within an acceptable level of interest rate risk. Interest rate risk can be defined as the amount of the forecasted net interest income that may be gained or lost due to favorable or unfavorable movements in interest rates. Interest rate risk, or sensitivity, arises when the maturity or repricing characteristics of assets differ significantly from the maturity or repricing characteristics of liabilities. 35 In the banking industry, a traditional measure of interest rate sensitivity is known as "gap" analysis, which measures the cumulative differences between the amounts of assets and liabilities maturing or repricing at various time intervals. The following table sets forth the Company's interest rate repricing gaps for selected maturity periods: Berkshire Bancorp Inc. Interest Rate Sensitivity Gap at December 31, 2004 (in thousands, except for percentages) -- 3 Months 3 Through 1 Through or Less 12 Months 3 Years ---------------- ----------------- ---------------- Federal funds sold 7,500 (Rate) 2.25% Interest bearing deposits in banks 372 -- -- (Rate) 1.40% Loans (1)(2) Adjustable rate loans 46,352 16,394 7,989 (Rate) 6.35% 5.06% 7.56% Fixed rate loans 546 5,564 16,732 (Rate) 7.35% 7.37% 6.84% --------- --------- --------- Total loans 46,898 21,958 24,721 Investments (3)(4) 25,587 34,963 187,503 (Rate) 4.64% 2.11% 2.95% --------- --------- --------- Total rate-sensitive assets 72,857 56,921 212,224 --------- --------- --------- Deposit accounts (5) Savings and NOW 277,616 -- -- (Rate) 1.59% Money market 25,772 -- -- (Rate) 0.73% Time Deposits 113,377 105,314 53,538 (Rate) 1.83% 1.92% 2.78% --------- --------- --------- Total deposit accounts 416,765 105,314 53,538 Repurchase Agreements 57,297 37,450 33,000 (Rate) 1.92% 2.49% 2.92% Other borrowings 2,638 43,296 (Rate) % 3.34% 3.61% --------- --------- --------- Total rate-sensitive liabilities 474,062 145,402 129,834 --------- --------- --------- Interest rate caps 20,000 (10,000) Gap (repricing differences) (421,205) (88,481) 92,390 ========= ========= ========= Cumulative Gap (421,205) (509,686) (417,296) ========= ========= ========= Cumulative Gap to Total Rate Sensitive Assets (45.84)% (55.47)% (45.42)% ========= ========= ========= Berkshire Bancorp Inc. Interest Rate Sensitivity Gap at December 31, 2004 (in thousands, except for percentages) -- Over 3 Years Total Fair Value ---------------- ----------------- ---------------- Federal funds sold 7,500 7,500 (Rate) Interest bearing deposits in banks -- 372 372 (Rate) 1.40% Loans (1)(2) Adjustable rate loans 16,124 86,859 91,219 (Rate) 6.41% 6.13% Fixed rate loans 178,062 200,904 200,241 (Rate) 6.29% 6.82% --------- ---------- Total loans 194,186 287,763 291,460 Investments (3)(4) 382,620 630,673 631,601 (Rate) 4.39% 3.85% --------- ---------- Total rate-sensitive assets 576,806 918,808 --------- ---------- Deposit accounts (5) Savings and NOW -- 277,616 277,616 (Rate) 1.59% Money market -- 25,772 28,882 (Rate) 0.73% Time Deposits 2,080 274,309 273,397 (Rate) 1.97% 2.05% --------- ---------- Total deposit accounts 2,080 577,697 Repurchase Agreements -- 127,747 127,422 (Rate) -- 2.35% Other borrowings 65,135 111,069 112,598 (Rate) 4.17% 3.94% --------- ---------- Total rate-sensitive liabilities 67,215 816,513 --------- ---------- Interest rate caps (10,000) 26 Gap (repricing differences) 519,591 102,295 ========= ========== Cumulative Gap 102,295 ========= Cumulative Gap to Total Rate Sensitive Assets 11.13% ========= ---------- (1) Adjustable-rate loans are included in the period in which the interest rates are next scheduled to adjust rather than in the period in which the loans mature. Fixed-rate loans are scheduled according to their maturity dates. (2) Includes nonaccrual loans. (3) Investments are scheduled according to their respective repricing (variable rate loans) and maturity (fixed rate securities) dates. (4) Investments are stated at book value. (5) NOW accounts and savings accounts are regarded as readily accessible withdrawal accounts. The balances in such accounts have been allocated among maturity/repricing periods based upon The Berkshire Bank's historical experience. All other time accounts are scheduled according to their respective maturity dates. 36 Impact of Inflation and Changing Prices The Company's financial statements measure financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increasing cost of the Company's operations. The assets and liabilities of the Company are largely monetary. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. In addition, interest rates do not necessarily move in the direction, or to the same extent as the price of goods and services. However, in general, high inflation rates are accompanied by higher interest rates, and vice versa. New Accounting Pronouncements Loan Commitments In March 2004, the Securities and Exchange Commission (the "SEC") staff issued Staff Accounting Bulletin ("SAB") 105 ("SAB 105"), "Application of Accounting Principles to Loan Commitments." The SEC staff does not believe an asset results from the expected future cash flows of servicing a committed loan until the servicing assets have been contractually separated from the underlying loan by sale or securitization of the loan with the servicing retained. SAB 105 is effective for all new loan commitments entered into beginning April 1, 2004. We have followed an accounting methodology consistent with the guidance in SAB 105; accordingly, the adoption of SAB 105 has not had a material effect on our consolidated financial statements. Stock-Based Compensation In December 2004, the Financial Accounting Standards Board (the "FASB") issued Statement No. 123 (Revised), Share-based Payment, ("FAS 123(R)"). FAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. We will be required to apply FAS 123(R) in the third quarter of 2005. The scope of FAS 123(R) includes a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. FAS 123(R) replaces FASB Statement 123, Accounting for Stock-Based Compensation ("FAS 123"), and supersedes the Accounting Principles Board (the "APB") Opinion No. 25, Accounting for Stock Issued to Employees ("APB Opinion No. 25"). FAS 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, FAS 123 permitted entities the option of continuing to apply the guidance in APB Opinion No. 25, as long as the footnotes to financial statements disclosed what net income would have been had the had the preferable fair-value-based method been used. FAS 123(R) provides three methods for companies to transition to the new standard requiring the expensing of options. Companies may elect to (i) restate results for prior quarters in the fiscal year of adoption of FAS 123(R) to reflect the FAS 123 proforma compensation costs, or (ii) restate results for prior periods, whether annual or quarterly, to reflect the FAS 123 proforma compensation costs. We are in the process of determining which transition approach to use and the effect, if any, such transition approach will have on our financial statements. Accounting for Loans or Certain Debt Securities Acquired in a Transfer In October 2003, the American Institute of Cetified Public Accountants (the "AICPA") issued SOP 03-3, Accounting for Loans or Certain Debt Securities Acquired in a Transfer. SOP 03-3 applies to a loan with the evidence of deterioration of credit quality since origination acquired by completion of a transfer for which it is probable at acquisition, that the Company will be unable to collect all contractually required payments receivable. SOP 03-3 requires that the Company recognize the excess of all cash flows expected at acquisition over the investor's initial investment in the loan as interest income on a level-yield basis over the life of the loan as the accretable yield. The loan's 37 contractual required payments receivable in excess of the amount of its cash flows excepted at acquisition (nonaccretable difference) should not be recognized as an adjustment to yield, a loss accrual or a valuation allowance for credit risk. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 31, 2004. Early adoption is permitted. Management is currently evaluating the provisions of SOP 03-3. Variable Interest Entities In January 2003, the FASB released Interpretation No. 46, Consolidation of Variable Interest Entities ("FIN 46"). Fin 46 requires that all primary beneficiaries of Variable Interest Entities ("VIE") consolidate that entity. FIN 46 is effective immediately for VIEs created after January 31, 2003 and to VIEs to which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003, to VIEs in which an enterprise holds a variable interest it acquired before February 1, 2003. In December 2003, the FASB published a revision to FIN 46 ("FIN 46R") to clarify some of the provisions of the interpretation and to defer the effective date of implementation for certain entities. Under the guidance of FIN 46R, entities that do not have interests in structures that are commonly referred to as special purpose entities are required to apply the provisions of the interpretation in financial statements for periods ending after March 14, 2004. We do not have interests in special purpose entities and, accordingly, applied the provisions of FIN 46R with our first quarter 2004 financial statements. The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments In November 2003, the Emerging Issues Task Force (the "EITF") of the FASB issued EITF Abstract 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments" (EITF 03-1). The quantitative and qualitative disclosure provisions of EITF 03-1 are effective for years ending after December 15, 2003 and were included in the Company's 2003 Form 10-K. In March 2004, the EITF issued a Consensus on Issue 03-1 requiring that the provisions of EITF 03-1 be applied for reporting periods beginning after June 15, 2004 to investments accounted for under SFAS Nos. 115 and 124. EITF 03-1 establishes a three-step approach for determining whether an investment is considered impaired, whether that impairment is other-than-temporary, and the measurement of an impairment loss. In September 2004, the FASB issued a proposed Board-directed FASB Staff Position, FSP EITF Issue 03-1-a, "Implementation Guidance for the Application of Paragraph 16 of EITF 03-1." The proposed FSP would provide implementation guidance with respect to debt securities that are impaired solely due to interest rates and/or sector spreads and analyzed for other-than-temporary impairment under paragraph 16 of EITF 03-1. The Board has directed the FASB staff to delay the effective date for the measurement and recognition guidance contained in paragraphs 10-20 of EITF Issue No. 03-1, including steps two and three of the three-step approach for determining whether an investment is other-than-temporarily impaired. However, step one of that approach must still be initially applied for impairment evaluations in reporting periods beginning after June 15, 2004. The delay of the effective date for paragraphs 10-20 of EITF Issue 03-1 will be superseded with the final issuance of proposed FSP EITF Issue 03-1-a, "Implementation

Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1." The Company is in the process of determining the impact that this EITF will have on its financial statements. Internal Control Over Financial Reporting The current objective of the Bank's Internal Control Program is to allow management to comply with FDICIA requirements and with Section 302 of the Sarbanes-Oxley Act of 2002 (the "Act"). Section 302 of the Act requires the CEOs and CFOs of the Company to (i) certify that the annual and quarterly reports filed with the Securities and Exchange Commission are accurate and (ii) acknowledge that they are responsible for establishing, maintaining and periodically evaluating the effectiveness of the disclosure controls and procedures. Section 404 of the Act requires management to report on internal control over financial reporting. The SEC requires us to comply with Section 404 by the year ending December 31, 2006. 38 The Committee of Sponsoring Organizations (COSO) methodology may be used to document and test the internal controls pertaining to the accuracy of Company issued financial statements and related disclosures. COSO requires a review of the control environment (including anti-fraud and audit committee effectiveness), risk assessment, control activities, information and communication, and ongoing monitoring. ITEM 7A. Quantitative and Qualitative Disclosure About Market Risk. See Item 7. Managements' Discussion and Analysis of Financial Condition and Results of Operations - Interest Rate Risk ITEM 8. Financial Statements and Supplementary Data. 39 Report of Independent Registered Public Accounting Firm Board of Directors and Shareholders of Berkshire Bancorp Inc. We have audited the accompanying consolidated statements of financial position of Berkshire Bancorp Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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, 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Berkshire Bancorp Inc. and Subsidiaries as of December 31, 2004 and 2003, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. We have also audited, in accordance with the interim standards adopted by the Public Company Accounting Oversight Board (United States), the effectiveness of The Berkshire Bank's (a subsidiary of Berkshire Bancorp Inc.) internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 29, 2005 expressed an unqualified opinion on management's assertion that The Berkshire Bank maintained effective internal control over financial reporting. /s/ GRANT THORNTON LLP Philadelphia, Pennsylvania March 29, 2005 40 BERKSHIRE BANCORP INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Dollars in Thousands) December 31, December 31, 2004 2003 --------------------------- ASSETS Cash and due from banks $ 9,511 $ 7,478 Interest bearing deposits 372 1,832 Federal funds sold 7,500 -- --------- --------- Total cash and cash equivalents 17,383 9,310 Investment Securities: Available-for-sale 630,968 569,137 Held-to-maturity, fair value of $633 in 2004 and $715 in 2003 624 711 --------- --------- Total investment securities 631,592 569,848 Loans, net of unearned income 286,979 294,756 Less: allowance for loan losses (2,927) (2,593) --------- --------- Net loans 284,052 292,163 Accrued interest receivable 6,014 5,298 Premises and equipment, net 8,677 8,665 Goodwill, net 18,549 18,549 Other assets 6,382 1,836 --------- --------- Total assets $ 972,649 $ 905,669 ========= ========= LIABILITIES AND STOCKHOLDERS' EQUITY Deposits: Non-interest bearing $ 42,191 $ 38,422 Interest bearing 577,697 565,833 --------- --------- Total deposits 619,888 604,255 Securities sold under agreements to repurchase 127,747 114,391 Long term borrowings 95,605 77,745 Subordinated debt 15,464 -- Accrued interest payable 2,516 2,208 Other liabilities 3,810 3,580 --------- --------- Total liabilities 865,030 802,179 --------- --------- Stockholders' equity Preferred stock - $.10 Par value: -- -- 2,000,000 shares authorized - none issued Common stock - $.10 par value Authorized -- 10,000,000 shares Issued -- 7,698,285 shares Outstanding -- December 31, 2004, 6,748,675 shares December 31, 2003, 6,614,094 shares 770 256 Additional paid-in capital 89,543 89,866 Retained earnings 28,983 22,960 Accumulated other comprehensive (loss) income, net

(2,602) 775 Treasury Stock December 31, 2004, 949,610 shares December 31, 2003, 1,084,191 shares (9,075) (10,367) --------- --------- Total stockholders' equity 107,619 103,490 --------- --------- $ 972,649 $ 905,669 ========= ========= The accompanying notes are an integral part of these statements 41 BERKSHIRE BANCORP INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME (In Thousands, Except Per Share Data) For The Years Ended December 31, -- 2004 2003 2002 -------- -------- -------- INTEREST INCOME Federal funds sold and interest bearing deposits $ 63 $ 44 $ 136 Investments securities 21,120 15,321 13,383 Loans, including related fees 18,825 19,061 18,723 -------- -------- -------- Total interest income 40,008 34,426 32,242 -------- -------- -------- INTEREST EXPENSE Deposits 9,833 10,130 10,410 Short-term borrowings 2,422 794 687 Long-term borrowings 3,661 2,723 2,319 -------- -------- -------- Total interest expense 15,916 13,647 13,416 -------- -------- -------- Net interest income 24,092 20,779 18,826 PROVISION FOR LOAN LOSSES 180 240 387 -------- -------- -------- Net interest income after provision for loan losses 23,912 20,539 18,439 -------- -------- -------- NON-INTEREST INCOME Service charges on deposit accounts 520 640 548 Investment securities gains 793 2,746 1,539 Other income 506 597 200 -------- -------- -------- Total non-interest income 1,819 3,983 2,287 -------- -------- -------- NON-INTEREST EXPENSE Salaries and employee benefits 6,886 5,873 5,183 Net occupancy expense 1,538 1,611 1,625 Equipment expense 357 397 312 FDIC assessment 115 80 66 Data processing expense 157 183 193 Other 3,042 3,319 3,401 -------- -------- -------- Total non-interest expense 12,095 11,463 10,780 -------- -------- -------- Income before provision for taxes 13,636 13,059 9,946 Provision for income taxes 6,134 5,644 4,349 -------- -------- -------- Net income $ 7,502 $ 7,415 $ 5,597 ======== ======== ======== Net income per share: Basic $ 1.12 $ 1.12 $ .81 ======== ======== ======== Diluted $ 1.10 $ 1.10 $ .81 ======== ======== ======== Dividends per share $ .11 $ .09 $ .07 The accompanying notes are an integral part of these statements 42 BERKSHIRE BANCORP INC. AND SUBSIDIARIES CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY For The Years Ended December 31, 2004, 2003 and 2002 (In Thousands) Accumulated Common Stock Additional other Par paid-in comprehensive Shares value capital (loss) net ------ ----- --------- ----------- Balance at January 1, 2002 2,566 $256 $89,914 $ (281) Net income Acquisition of treasury shares Exercise of stock options (24) Other comprehensive income net of reclassification adjustment and taxes 1,761 Comprehensive income Cash dividends ------ ---- ------- ------ Balance at December 31, 2002 2,566 $256 $89,890 $1,480 Net income Acquisition of treasury shares Exercise of stock options (24) Other comprehensive (loss) net of reclassification adjustment and taxes (705) Comprehensive income Cash dividends ------ ---- ------- ------ Balance at December 31, 2003 2,566 $256 $89,866 $ 775 Net income Exercise of stock options (90) Acquisition of treasury shares Effect of reverse one-for-ten stock split (2,309) (230) (233) Effect of thirty-for-one stock dividend 7,441 744 Other comprehensive (loss) net of reclassification adjustment and taxes (3,377) Comprehensive income Cash dividends Balance at December 31, 2004 7,698 $770 $89,543 $(2,602) ==== ======= ======= Total Retained Treasury Comprehensive stockholders' earnings stock income equity -------- ------- -------- ------- Balance at January 1, 2002 $ 11,053 $(4,950) $ 95,992 Net income 5,597 5,597 5,597 Acquisition of treasury shares (4,422) (4,422) Exercise of stock options 126 102 Other comprehensive income net of reclassification adjustment and taxes 1,761 1,761 ------- Comprehensive income $ 7,358 ======= Cash dividends (505) (505) -------- ------- -------- Balance at December 31, 2002 $ 16,145 $(9,246) $ 98,525 Net income 7,415 7,415 7,415 Acquisition of treasury shares (1,350) (1,350) Exercise of stock options 229 205 Other comprehensive (loss) net of reclassification adjustment and taxes (705) (705) ------- Comprehensive income $ 6,710 ======= Cash dividends (600) (600) -------- -------- -------- Balance at December 31, 2003 $ 22,960 $(10,367) $103,490 Net income 7,502 7,502 7,502 Exercise of stock options 1,361 1,271 Acquisition of treasury shares (69) (69) Effect of reverse one-for-ten stock split (463) Effect of thirty-for-one stock dividend (744) Other comprehensive (loss) net of reclassification adjustment and taxes (3,377) (3,377) ------- Comprehensive income $ 4,125 ======= Cash dividends (735) (735) Balance at December 31, 2004 $ 28,983 $ (9,075) $107,619 ======== ======== ======== The accompanying notes are an integral part of these statements 43 BERKSHIRE BANCORP INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (in thousands) For The Years Ended December 31, -- 2004 2003 2002 ------ ------ ----- CASH FLOWS FROM OPERATING ACTIVITIES: Net income $ 7,502 $ 7,415 $ 5,597 Adjustments to reconcile net income to net cash provided by (used in) operating activities: Realized gains on investment securities (793) (4,151) (1,729) Net amortization of premiums of investment securities 2,282 1,405 190 Depreciation and amortization 590 605 414 Provision for loan losses 180 240 387 Increase in deferred taxes -- 204 (133) CHANGES IN ASSETS AND LIABILITIES: (Increase) in accrued interest receivable (716) (1,192) (707)

(Increase) decrease in other assets (3,873) (1,064) 3,026 Increase (decrease) in accrued interest payable and other liabilities 538 (1,054) 1,316 ----------- ----------- ----------- Net cash provided by operating activities 5,710 2,408 8,361 ----------- ----------- ----------- CASH FLOWS FROM INVESTING ACTIVITIES: Investment securities available for sale Purchases (1,740,889) (1,837,653) (1,729,416) Sales, maturities and calls 1,674,188 1,641,186 1,603,261 Investment securities held to maturity Purchases 91 -- -- Maturities -- 118 780 Net decrease (increase) in loans 7,931 (19,221) (23,559) Acquisition of premises and equipment (602) (294) (2,055) ----------- ----------- ----------- Net cash (used in) investing activities (59,281) (215,864) (150,989) ----------- ----------- ----------- 44 BERKSHIRE BANCORP INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (in thousands) For The Years Ended December 31, -- 2004 2003 2002 ------ ------ ----- CASH FLOWS FROM FINANCING ACTIVITIES: Net increase in non interest bearing deposits 3,769 7,102 1,157 Net increase in interest bearing deposits 11,864 123,335 133,885 Increase (decrease) in securities sold under agreements to repurchase 13,356 67,718 (7,083) Proceeds from long term debt 37,164 20,046 34,923 Repayment of long term debt (19,304) -- (19,502) Proceeds from issuance of subordinated debentures, net 14,791 -- -- Acquisition of treasury stock (69) (1,350) (4,422) Proceeds from exercise of common stock options 1,271 205 102 Cash paid for fractional shares (463) -- -- Dividends paid (735) (600) (505) ----------- ----------- ----------- Net cash provided by financing activities 61,644 216,456 138,555 ----------- ----------- ----------- Net increase (decrease) in cash and cash equivalents 8,073 3,000 (4,073) Cash and cash equivalents at beginning of year $ 9,310 $ 6,310 $ 10,383 ----------- ----------- ----------- Cash and cash equivalents at end of year $ 17,383 $ 9,310 $ 6,310 =========== =========== =========== SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: Cash used to pay interest $ 15,608 $ 14,787 $ 12,474 Cash used to pay income taxes, net of refunds $ 5,960 $ 2,015 $ 5,692 The accompanying notes are an integral part of these statements 45 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements December 31, 2004 and 2003 Note A - ORGANIZATION AND CAPITALIZATION Organization Berkshire Bancorp Inc. ("Berkshire" or the "Company" or "we" and similar pronouns), a Delaware corporation, is a bank holding company registered under the Bank Holding Company Act of 1956. Berkshire's principal activity is the ownership and management of its wholly owned subsidiary, The Berkshire Bank (the "Bank"), a New York State chartered commercial bank. The Bank was established in 1989 to provide highly personalized services to high net worth individuals and to small and mid-sized commercial businesses primarily from the New York City metropolitan area. In March 2001, the Company expanded its customer base and market area with the acquisition of GSB Financial Corporation. The Bank's main office and branch is in mid-town Manhattan. The Bank has one other branch in lower Manhattan, three branches in Brooklyn, New York, and four branches in Orange and Sullivan Counties in New York State. The Bank competes with other banking and financial institutions in its markets. Commercial banks, savings banks, savings and loan associations, mortgage bankers and brokers, and credit unions actively compete for deposits and loans. Such institutions, as well as consumer finance, mutual funds, insurance companies, and brokerage and investment banking firms may be considered to be competitors of the Bank with respect to one or more of the services provided by the Bank. The Company and the Bank are subject to the regulations of certain state and federal agencies and, accordingly, are periodically examined by those regulatory authorities. As a consequence of such regulation of banking activities, the Bank's business may be affected by state and federal legislation. Stock Split and Stock Dividend At the Annual Meeting of Stockholders held on May 18, 2004, the Company's stockholders approved an amendment to the Company's Certificate of Incorporation effecting a one-for-ten reverse stock split of the Company's issued and outstanding Common Stock (the "Reverse Split"). Following the effectiveness of the Reverse Split, the Company's Board of Directors declared a thirty-for-one forward stock split in the form of a stock dividend in Common Stock (the "Stock Dividend) which became effective immediately. The Company paid approximately $463,000 to purchase fractional shares from stockholders as part of the Reverse Split. The Company's Common Stock began trading on May 19, 2004 giving effect to these transactions. Trust Preferred Securities As of May 18 2004, the Company established Berkshire Capital Trust I, a Delaware statutory trust, ("BCTI"). The Company owns all the common capital securities of BCTI. BCTI issued $15.0 million of preferred capital securities to investors in a private transaction and invested the proceeds, combined with the proceeds from the sale of BCTI's common capital securities, in the Company through the purchase of $15.464 million aggregate principal amount of Floating Rate Junior Subordinated Debentures (the "Debentures") issued by the Company. The Debentures, the sole assets of BCTI, mature on July 23, 2034 and bear interest at a floating rate, three month LIBOR plus 2.70%. Based on current interpretations of the banking regulators, the Debentures qualify under the risk-based capital guidelines of the Federal Reserve as Tier 1 capital, subject to certain limitations. The Debentures are callable by the Company, subject to any required regulatory approvals, at par, in whole or in part, at any time after five years from the date of issuance. The Company's obligations under the Debentures and related documents, taken together, constitute a full, irrevocable and unconditional guarantee on a subordinated basis by the Company of the obligations of BCTI under the preferred capital securities sold by BCTI to investors. FIN46(R) precludes consideration of the 46 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note A - (continued) call option embedded in the preferred capital securities when determining if the Company has the right to a majority of BCTI expected residual returns. Accordingly, BCTI is not included in the consolidated balance sheet of the Company. The Federal Reserve has issued guidance on the regulatory capital treatment for the trust-preferred securities issued by BCTI as a result of the adoption of FIN 46(R). This rule would retain the current maximum percentage of total capital permitted for Trust Preferred Securities at 25%, but would enact other changes to the rules governing Trust Preferred Securities that affect their use as part of the collection of entities known as "restricted core capital elements." The rule would take effect March 31, 2009; however, a five year transition period starting March 31, 2004 and leading up to that date would allow bank holding companies to continue to count Trust Preferred Securities as Tier 1 Capital after applying FIN-46(R). Management has evaluated the effects of this rule and does not anticipate a material impact on its capital ratios when the proposed rule is finalized. Note B - SUMMARY OF ACCOUNTING POLICIES 1. Basis of Financial Statement Presentation The consolidated financial statements include the accounts of Berkshire Bancorp Inc. and its wholly owned subsidiaries, Greater American Finance Group, Inc. ("GAFG"), East 39, LLC and the Bank, (collectively, the "Company"). All significant intercompany accounts and transactions have been eliminated. In preparing the financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the balance sheets, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The principal estimate that is susceptible to significant change in the near term relates to the allowance for loan losses and goodwill. The evaluation of the adequacy of the allowance for loan losses includes an analysis of the individual loans and overall risk characteristics and size of the different loan portfolios, and takes into consideration current economic and market conditions, the capability of specific borrowers to pay specific loan obligations, as well as current loan collateral values. However, actual losses on specific loans, which also are encompassed in the analysis, may vary from estimated losses. Substantially all outstanding goodwill resulted from the acquisition of The Berkshire Bank and Goshen Savings Bank, depository institutions concentrating in the New York City and Orange and Sullivan County communities, respectively. As the result of the market penetration in these New York areas, the Company had formulated its own strategy to create such a market role. Accordingly, implicit in the purchase of these franchises was the acquisition of that role. However, if such benefits, including new business, are not derived or the Company changes its business plan an impairment may be recognized. 47 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note B - (continued) The Company provides disclosures under Statement of Financial Accounting Standards ("SFAS") 131, "Disclosures About Segments of an Enterprise and Related Information." Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and assess performance. The Company has one operating segment and, accordingly, one reportable segment, "Community Banking." All of the Company's activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, commercial lending is dependent upon the ability of the Bank to fund itself with retail deposits and other borrowings and to manage interest rate and credit risk. This situation is also similar for consumer and residential mortgage lending. Accordingly, all significant operating decisions are based upon analysis of the Company as one operating segment or unit. 2. Investment Securities The Company accounts for its investment securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Investments in securities are classified in one of three categories: held to maturity, trading or available for sale. Investments for which management has both the ability and intent to hold to maturity, are carried at cost, adjusted for the amortization of premiums and accretion of discounts computed by the interest method. Investments which management believes may be sold prior to maturity due to changes in interest rates, prepayment risk and equity, liquidity requirements or other factors, are classified as available for sale. Available- for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of stockholders' equity and excluded from the determination of net income. Gains or losses on disposition are based on the net proceeds and cost of the securities sold, adjusted for amortization of premiums and accretion of discounts, using the specific identification method. In November 2003, the Financial Accounting Standards Board ("FASB") Emerging Issues Task Force ("EITF") reached consensus opinion on EITF Issue 03-1, "The Meaning of Other Than Temporary Impairment and Its Application to Certain Investments. The Company adopted EITF 03-1 as of December 31, 2003. EITF 03-1 includes certain disclosures regarding quantitative and qualitative disclosures for investment securities accounted for under SFAS No. 115 that are impaired at the balance sheet date, but an other-than-temporary impairment has not been recognized. The disclosures under EITF 03-1 are required for financial statements for years ending after December 15, 2003 and are included in these financial statements. Other-Than-Temporary Impairment - EITF 03-1 In November 2003, the Emerging Issues Task Force (EITF) of the FASB issued EITF Abstract 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments" (EITF 03-1). The quantitative and qualitative disclosure provisions of EITF 03-1 are effective for years ending after December 15, 2003 and were included in the Company's 2003 Form 10-K. In March 2004, the EITF issued a Consensus on Issue 03-1 requiring that the provisions of EITF 03-1 be applied for reporting periods beginning after June 15, 2004 to investments accounted for under SFAS Nos. 115 and 124. EITF 03-1 establishes a three-step approach for determining whether an investment is considered impaired, whether that impairment is other-than-temporary, and the measurement of an impairment loss. In September 2004, the FASB issued a proposed Board-directed FASB Staff Position, FSP EITF Issue 03-1-a, "Implementation Guidance for the Application of Paragraph 16 of EITF 03-1." The proposed FSP would provide implementation guidance with respect to debt securities that are impaired solely due to interest rates and/or sector spreads and analyzed for other-than-temporary impairment under paragraph 16 of EITF 03-1. The Board has directed the FASB staff to delay the effective date for the measurement and recognition guidance contained in paragraphs 10-20 of EITF Issue No. 03-1, 48 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note B - (continued) including steps two and three of the three-step approach for determining whether an investment is other-than-temporarily impaired. However, step one of that approach must still be initially applied for impairment evaluations in reporting periods beginning after June 15, 2004. The delay of the effective date for paragraphs 10-20 of EITF Issue 03-1 will be superseded with the final issuance of proposed FSP EITF Issue 03-1-a, "Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1." The Company is in the process of determining the impact that this EITF will have on its financial statements. 3. Loans and Allowance for Loan Losses Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal and are net of unearned discount, unearned loan fees and an allowance for credit losses. The allowance for loan losses is established through a provision for loan losses charged to expense. Loan principal considered to be uncollectible by management is charged against the allowance for credit losses. The allowance is an amount that management believes will be adequate to absorb losses on existing loans that may become uncollectible based upon an evaluation of known and inherent risks in the loan portfolio. The evaluation takes into consideration such factors as changes in the nature and size of the loan portfolio, overall portfolio quality, specific problem loans, and current economic conditions which may affect the borrowers' ability to pay. The evaluation details historical losses by loan category, the resulting loss rates for which are projected at current loan total amounts. Interest income is accrued as earned on a simple interest basis. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. When a loan is placed on such non-accrual status, all accumulated accrued interest receivable applicable to periods prior to the current year is charged off to the allowance for loan losses. Interest which had accrued in the current year is reversed out of current period income. Loans 90 days or more past due and still accruing interest must have both principal and accruing interest adequately secured and must be in the process of collection. The Company accounts for its impaired loans in accordance with SFAS No. 114, "Accounting by Creditors for Impairment of a Loan," as amended by SFAS No. 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures." This standard requires that a creditor measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral-dependent. Regardless of the measurement method, a creditor must measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable. The Company follows the provisions of SFAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," SFAS No. 140 is based on consistent application of a financial-components approach that recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered and derecognizes liabilities when extinguished. SFAS No. 140 provides consistent guidelines for distinguishing transfers of financial assets from transfers that are secured borrowings. The Company adopted SFAS 140 on April 1, 2001 and the adoption did not have a material impact upon the Company's consolidated financial statements. 49 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note B - (continued) Staff Accounting Bulletin (SAB) No. 102, "Selected Loan Loss Allowance Methodology and Documentation Issues" (SAB No. 102), codified in SAB No. 103, provides guidance on the development, documentation, and application of a systematic methodology for determining the allowance for loans and leases in accordance with US GAAP. The adoption of SAB No. 102 is not expected to have a material impact on the Company's financial position or results of operations. In October 2003, the AICPA issued SOP 03-3 Accounting for Loans or Certain Debt Securities Acquired in a Transfer. SOP 03-3 applies to a loan with the evidence of deterioration of credit quality since origination acquired by completion of a transfer for which it is probable at acquisition, that the Company will be unable to collect all contractually required payments receivable. SOP 03-3 requires that the Company recognize the excess of all cash flows expected at acquisition over the investor's initial investment in the loan as interest income on a level-yield basis over the life of the loan as the accretable yield. The loan's contractual required payments receivable in excess of the amount of its cash flows excepted at acquisition (nonaccretable difference) should not be recognized as an adjustment to yield, a loss accrual or a valuation allowance for credit risk. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 31, 2004. Early adoption is permitted. Management is currently evaluating the provisions of SOP 03-3. Loan Commitments Accounted for as Derivative Instruments The SEC staff recently released Staff Accounting Bulletin (SAB) 105, "Loan Commitments Accounted for as Derivative Instruments." SAB 105 provides guidance about the measurement of loan commitments recognized at fair value under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. SAB 105 also requires companies to disclose their accounting policy for those loan commitments including methods and assumptions used to estimate fair value and associated hedging strategies. SAB 105 is effective for all loan commitments accounted for as derivatives that are entered into after March 31, 2004. The adoption of SAB 105 did not have a material effect on our consolidated financial statements. The Company adopted SFAS No. 149 ("SFAS No. 149"), Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities, on July 1, 2003. SFAS No. 149 clarifies and amends SFAS No. 133 for implementation issues raised by constituents or includes the conclusions reached by the FASB on certain FASB Staff Implementation Issues. Statement No. 149 also amends SFAS No. 133 to require a lender to account for loan commitments related to mortgage loans that will be held for sale as derivatives. SFAS No. 149 is effective for contracts entered into or modified after September 30, 2003. The Company periodically enters into commitments with its customers, which it intends to sell in the future. The adoption of SFAS No. 149 did not have a material impact on the Company's financial position or results of operations. 4. Bank Premises and Equipment Bank premises and equipment, including leasehold improvements, are stated at cost less accumulated depreciation. Depreciation expense is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of the estimated useful lives of the improvements or the terms of the related leases. On January 1, 2002 the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 retains the existing requirements to recognize and measure the impairment of long-lived assets to be held and used or to be disposed of by sale. However, SFAS No. 144 makes changes to the scope and certain measurement requirements of existing accounting guidance. The adoption of this statement did not have a significant impact on the financial condition or results of operations of the Company. 50 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note B - (continued) 5. Other Real Estate Owned Other real estate owned, representing property acquired through foreclosure, is recorded at the lower of cost or estimated fair market value, less costs of disposal. When property is acquired, the excess, if any, of the loan balance over fair market value is charged to the allowance for loan losses. Periodically thereafter, the asset is reviewed for subsequent declines in the estimated fair market value. Subsequent declines, if any, and holding costs, as well as gains and losses on subsequent sale, are included in the consolidated statements of operations. 6. Goodwill Goodwill resulted from the acquisition of The Berkshire Bank in 1999 and GSB Financial Corporation in 2001. The Company adopted SFAS No. 142, Goodwill and Intangible Assets, on January 1, 2002. SFAS No. 142 includes requirements to test goodwill and indefinite lived intangible assets for impairment rather than amortize them. The Company did not identify any impairment on its outstanding goodwill and its identifiable intangible assets from its most recent testing, performed at December 31, 2004. 7. Income Taxes The Company accounts for income taxes under the liability method of accounting for income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Deferred tax expense is the result of changes in deferred tax assets and liabilities. The principal types of differences between assets and liabilities for financial statement and tax return purposes are allowance for loan losses, deferred loan fees, deferred compensation and securities available for sale. 8. Net Income Per Share The Company follows the provisions of SFAS No. 128, "Earnings Per Share." Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted-average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock. All weighted average share and per share information in 2003 and 2002 have been retroactively restated to reflect the stock split and stock dividend discussed in Note A. 9. Stock Based Compensation In December 2004, the Financial Accounting Standards Board (the "FASB") issued Statement No. 123 (Revised), Share-based Payment, ("FAS 123(R)"). FAS 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. We will be required to apply FAS 123(R) in the third quarter of 2005. The scope of FAS 123(R) includes a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. FAS 123(R) replaces FASB Statement 123, Accounting for Stock-Based Compensation ("FAS 123"), and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. FAS 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, FAS 123 permitted entities the option of continuing to apply the guidance in APB Opinion No. 25, as long as the footnotes to financial statements disclosed what net income would have been had the had the preferable fair-value- based method been used. 51 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note B - (continued) The Company follows the disclosure provisions of FAS 123 which introduced a method of accounting for employee stock-based compensation plans based upon the fair value of the awards on the date they are granted. Under this fair-value- based method, public companies estimate the fair value of stock options using a pricing model, such as the Black-Scholes model, which requires inputs such as the expected volatility of the stock price and an estimate of the dividend yield over the option's expected life. The FASB, however, does not require the use of this method until the first quarter of our 2006 fiscal year. Entities that continue to account for stock option plans under the existing method (APB No. 25) are required to disclose proforma net income and earnings per share, as if the fair value method had been used. At December 31, 2004, the Company has one stock-based employee compensation plan, which is more fully described in Note K. The Company accounts for that plan under the recognition and measurement principles of APB No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Stock-based employee compensation costs are not reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation. For The Years Ended December 31, ------------------------------------ 2004 2003 2002 ---- ---- ---- (In thousands, except per share amounts) Net income As Reported: $ 7,502 $ 7,415 $ 5,597 Less: Stock based compensation costs determined under fair value methods for all awards -- 32 680 ------- ------- ------- Pro Forma: $ 7,502 $ 7,383 $ 4,917 ======= ======= ======= Basic earnings per share As Reported: $ 1.12 $ 1.12 $ .81 Pro Forma: 1.12 1.11 .72 Diluted earnings per share As Reported: 1.10 1.10 .81 Pro Forma: 1.10 1.09 .71 The fair value of each option is estimated on the date of grant using the Black-Scholes options-pricing model using weighted-average assumptions for expected volatility, risk-free interest and expected life of the option. The Company did not grant stock options in 2004, 2003 and 2002. 10. Cash Equivalents The Company considers all highly liquid debt investments purchased with an original maturity of three months or less, and amounts due from brokers to be cash equivalents. 11. Restrictions on Cash and Due From Banks The Bank is required to maintain reserves against customer demand deposits by keeping cash on hand or balances with the Federal Reserve Bank in a non-interest bearing account. The amounts of those reserve and cash balances was approximately $2,763,000, $1,032,000 and $1,155,000 at December 31, 2004, 2003 and 2002, respectively. 52 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note B - (continued) 12. Comprehensive Income The Company follows the provisions of SFAS No. 130, "Reporting Comprehensive Income" which includes net income as well as certain other items, which results in a change to equity during the period. (In thousands.) Year Ended December 31, 2004 -- Tax Before tax (expense) Net of tax amount benefit Amount ---------------- ------------- -------------- Unrealized gains (losses) on investment securities: Unrealized holding gains arising during period $ (4,014) $ 1,711 $ (2,303) Less reclassification adjustment for gains realized in net income 793 (317) 476 -------- ------- -------- Unrealized (loss) on investment securities (4,807) 2,028 (2,779) Change in minimum pension liability (598) (598) -------- ------- -------- Other comprehensive income (loss), net $ (5,405) $ 2,028 $ (3,377) ======== ======= ======== Year Ended December 31, 2003 -- Tax Before tax (expense) Net of tax amount benefit Amount ------------- -------------- -------------- Unrealized gains (losses) on investment securities: Unrealized holding gains arising during period $ 1,231 $ (491) $ 740 Less reclassification adjustment for gains realized in net income 2,746 (1,097) 1,649 -------- -------- --------- Unrealized (loss) on investment securities (1,515) 606 (909) Change in minimum pension liability 340 (136) 204 -------- -------- --------- Other comprehensive income (loss), net $ (1,175) $ 470 $ (705) ======== ======== ========= Year Ended December 31, 2002 -- Tax Before tax (expense) Net of tax amount benefit Amount ------------- -------------- -------------- Unrealized gains on investment securities: Unrealized holding gains arising during period $ 4,760 $ (1,872) $ 2,888 Less reclassification adjustment for gains realized in net income 1,539 (616) 923 ------- -------- -------- Unrealized gain on investment securities 3,221 (1,256) 1,965 Minimum pension liability (340) 136 (204) ------- -------- -------- Other comprehensive income, net $ 2,881 $ (1,120) $ 1,761 ======= ======== ======== 13. Reclassifications Certain amounts in the December 31, 2003 and 2002 financial statements have been reclassified to conform to the current period's presentation. 53 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note C - INVESTMENT SECURITIES The following is a summary of held to maturity investment securities: December 31, 2004 -- Gross Gross Amortized unrealized unrealized Fair Cost gains losses value ------------- --------------- -------------- -------------- (In thousands) Investment securities U.S. Government Agencies $ 624 $ 10 $ (1) $ 633 ------- ------- -------- -------- Totals $ 624 $ 10 $ (1) $ 633 ======= ======= ======= ======== December 31, 2004 -- Gross Gross Amortized unrealized unrealized Fair Cost gains losses value ------------- --------------- -------------- -------------- (In thousands) Investment securities U.S. Government Agencies $ 711 $ 4 $ -- $ 715 ------- ------- -------- -------- Totals $ 711 $ 4 $ -- $ 715 ======= ======= ======= ======== The following is a summary of available-for-sale investment securities: December 31, 2004 -- Gross Gross Amortized unrealized unrealized Fair Cost gains losses value ------------- --------------- -------------- -------------- (In thousands) Investment securities U.S. Treasury and Notes $ 24,896 $ -- $ (174) $ 24,722 U.S. Government Agencies 471,018 97 (3,844) 467,271 Mortgage-backed securities 109,822 504 (996) 109,330 Corporate notes 21,089 692 (154) 21,627 Municipal securities 1,307 134 -- 1,441 Marketable equity securities and other 6,363 279 (65) 6,577 -------- ------- ------- -------- Totals $634,495 $ 1,706 $(5,233) $630,968 ======== ======= ======= ======== 54 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note C - (continued) December 31, 2004 -- Gross Gross Amortized unrealized unrealized Fair Cost gains losses value ------------- --------------- -------------- -------------- (In thousands) Investment securities U.S. Treasury and Notes $ 39,941 $ -- $ (94) $ 39,847 U.S. Government Agencies 419,175 637 (3,059) 416,753 Mortgage-backed securities 93,875 3,838 (265) 97,448 Corporate notes 1,570 214 (122) 1,662 Municipal securities 991 70 -- 1,061 Marketable equity securities and other 12,305 177 (116) 12,366 -------- ------- ------- -------- Totals $567,857 $ 4,936 $(3,656) $569,137 ======== ======= ======= ======== The Company has investments in certain debt and equity securities that have unrealized losses or may be otherwise impaired, but an other-than-temporary impairment has not been recognized in the financial statements. The following table indicates the length of time individual securities have been in a continuous unrealized loss position at December 31, 2004 (in thousands): Less than 12 months 12 months or longer Total ---------------------------- ----------------------------

---------------------------- Description of Securities Fair Value Unrealized Fair Value Unrealized Fair Value Unrealized Losses Losses Losses U.S. Treasury and Notes $ 14,796 $ 132 $ 9,926 $ 42 $ 24,722 $ 174 U.S. Government Agencies 253,526 1,586 192,661 2,259 446,187 3,845 Mortgage-backed securities 73,271 897 8,924 99 82,195 996 Corporate notes 4,941 58 -- 96 4,941 154 Municipal securities -- -- -- -- -- -- -------- ------- -------- ------- -------- ------- Subtotal, debt securities 346,534 2,673 211,511 2,496 558,045 5,169 Marketable equity -- -- 78 65 78 65 -------- ------- -------- ------- -------- ------- securities and other Total temporarily impaired securities $346,534 $ 2,673 $211,589 $ 2,561 $558,123 $ 5,234 ======== ======= ======== ======= ======== ======= The Company had a total of 97 debt securities with a fair market value of $558.05 million which were temporarily impaired at December 31, 2004. The total unrealized loss on these securities was $5.17 million, all but $96,000 of such unrealized loss being attributable to interest rate movements. We have the ability to hold these securities, all but 2 of which are US Government and US Government Agency securities to maturity, therefore, the unrealized losses associated with these securities are not considered to be other than temporary. We also had 4 equity securities with an aggregated fair market value of $78,000 which were temporarily impaired at December 31, 2004. The total unrealized loss on these securities was $65,000. Based upon our review of the available information, such unrealized losses are not considered to be other than temporary. 55 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE C - (continued) The amortized cost and fair value of investment securities available for sale and held to maturity, by contractual maturity, at December 31, 2004 and 2003 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. December 31, 2004 --- Available for Sale Held to Maturity ---------------------------------- --------------------------------- Amortized Fair Amortized Fair Cost Value Cost Value --------- ---- --------- ---- (In thousands) Due in one year or less $ 24,941 $ 24,862 $ -- $ -- Due after one through five years 185,421 184,416 58 59 Due after five through ten years 211,919 209,806 93 93 Due after ten years 198,440 197,192 473 481 Marketable equity securities and other 13,774 14,692 -- -- -------- -------- -------- -------- Totals $634,495 $630,968 $ 624 $ 633 ======== ======== ======== ======== December 31, 2003 --- Available for Sale Held to Maturity ---------------------------------- --------------------------------- Amortized Fair Amortized Fair Cost Value Cost Value --------- ---- --------- ---- (In thousands) Due in one year or less $ -- $ -- $ -- $ -- Due after one through five years 102,626 102,654 74 74 Due after five through ten years 196,934 195,168 70 70 Due after ten years 255,992 258,949 567 571 Marketable equity securities and other 12,305 12,366 -- -- -------- -------- -------- -------- Totals $567,857 $569,137 $ 711 $ 715 ======== ======== ======== ======== Gross gains realized on the sales of investment securities for the years ended December 31, 2004, 2003 and 2002 were $965,000, $2.91 million and $1.54 million, respectively. Gross losses were $172,000 and $163,000 for the years ended December 31, 2004 and 2003. Gross losses were not material for the year ended December 31, 2002. As of December 31, 2004 and 2003, securities sold under agreements to repurchase with a book value of approximately $127.75 million and $114.39 million, respectively, were outstanding. As of December 31, 2004 and 2003, the Company did not have any investment securities of any one issuer where the carrying value exceeded 10% of shareholders' equity. On November 7, 2002, we sold our 24.9% interest in a merchant credit card processing company for $285,000, which represents our initial purchase price in December 1999. We accounted for our interest in this company under the equity method of accounting and have recorded approximately $200,000 in net losses since December 1999. In addition, the Bank had loans outstanding totaling $295,000 to this company which are being repaid as a result of this transaction. At December 31, 2003, the purchase price to Berkshire had been paid in full. 56 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE D - LOANS Major classifications of loans are as follows: December 31, December 31, 2004 2003 ---------------- ---------------- (In thousands) Commercial and professional loans $ 16,498 $ 22,228 Secured by real estate 1 - 4 family 155,079 169,589 Multi family 4,600 6,608 Non-residential 109,597 94,956 Consumer 1,989 2,239 -------- -------- 287,763 295,620 Deferred loan fees (784) (864) Allowance for loan losses (2,927) (2,593) -------- -------- $284,052 $292,163 ======== ======== Changes in the allowance for loan losses are as follows: For The Years Ended December 31, -- 2004 2003 2002 ---------------- --------------- ----------------- (In thousands) Balance at beginning $ 2,593 $ 2,315 $ 2,030 of year Provision charged to 180 240 387 operations Loans charged off 24 17 199 Recoveries 178 55 97 ------- ------- ------- Balance at end of year $ 2,927 $ 2,593 $ 2,315

======= ======= ======= The Company had $343,000, $109,000 and $59,000 non accrual loans as of December 31, 2004, 2003 and 2002, respectively, and $50,000 of loans delinquent more than ninety days and still accruing interest at December 31, 2004. The Company did not have any impaired loans or loans past due more than 90 days and still accruing interest as of December 31, 2003 and 2002. The Company, from time to time, enters into lending transactions in the ordinary course of business with directors, executive officers, principal stockholders and affiliates of such persons on the same terms as those prevailing for comparable transactions with other borrowers. At December 31, 2004, loans to these related parties amounted to $10.4 million, were current as to principal and interest payments, and do not involve more than normal risk of collectibility. An analysis of activity in loans to related parties at December 31, 2004, resulted in new loans of $5.7 million and repayments of approximately $5.7 million. 57 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE E - PREMISES AND EQUIPMENT Major classifications of premises and equipment are summarized as follows: Estimated December 31, December 31, useful lives 2004 2003 ------------------- ------------------- ------------------ (In thousands) Land Indefinite $ 3,817 $ 3,817 Buildings 39 years 4,059 4,059 Furniture and equipment 3 to 10 years 2,573 2,318 Leasehold improvements 2 to 10 years 968 620 ------- ------- 11,417 10,814 Accumulated depreciation and amortization (2,740) (2,149) ------- ------- Total $ 8,677 $ 8,665 ======= ======= Depreciation and amortization expense was approximately $591,000, $605,000 and $279,000 for the years ended December 31, 2004, 2003 and 2002, respectively. NOTE F - DEPOSITS The aggregate amount of jumbo certificates of deposits greater than $100,000 were approximately $109.74 million and $110.08 million as of December 31, 2004 and 2003, respectively. The scheduled maturities of all certificates of deposit are as follows: December 31, 2004 ---------------- (In thousands) 2005 $218,680 2006 51,673 2007 1,877 2008 2,026 2009 53 --------- $ 274,309 ========= NOTE G - BORROWINGS Short-Term Borrowings Securities sold under agreements to repurchase generally mature within 30 days from the date of the transactions. Short-term borrowings consist of various borrowings which generally have maturities of less than one year. The details of these categories are presented below: Year Ended December 31, --- 2004 2003 2002 -------------- -------------- -------------- (Dollars in Thousands) Securities sold under repurchase agreements and federal funds purchased Balance at year-end $127,747 $114,391 $ 46,673 Average during the year $129,794 $ 57,554 $ 38,433 Maximum month-end balance $148,753 $114,391 $ 47,407 Weighted average rate during the year 1.87% 1.68% 1.79% Rate at December 31 2.27% 1.73% 1.46% 58 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note G - (continued) Long-Term Borrowings At December 31, 2004, advances from the Federal Home Loan Bank ("FHLB") totaling $95.6 million will mature within one to ten years and are reported as long-term borrowings. The advances are collateralized by FHLB stock and certain first mortgage loans. The advances had a weighted average rate of 3.83%. Unused lines of credit at the FHLB were $46.5 million at December 31, 2004. Outstanding long-term borrowings mature as follows (in thousands): Year Amount ------ --------- 2005 $ 2,638 2006 8,719 2007 34,578 2008 19,976 2009 15,694 Thereafter 14,000 --------- Total $ 95,605 ========= NOTE H - EARNINGS PER SHARE The Company's calculation of earnings per share in accordance with SFAS No. 128 is as follows: Year Ended December 31, 2004 (In thousands, except per share data) --- Income Shares Per share (numerator) (denominator) amount ---------------- ------------------ ---------------- Basic earnings per share Net income available to common stockholders $ 7,502 6,672 $ 1.12 Effect of dilutive securities Options -- 176 (.02) ------- ------- ------ Diluted earnings per share Net income available to common stockholders plus assumed conversions $ 7,502 6,848 $ 1.10 ======= ======= ====== Year Ended December 31, 2003 (In thousands, except per share data) --- Income Shares Per share (numerator) (denominator) amount ---------------- ------------------ ---------------- Basic earnings per share Net income available to common stockholders $ 7,415 6,636 $ 1.12 Effect of dilutive securities Options -- 111 (.02) ------- ------- ------ Diluted earnings per share Net income available to common stockholders plus assumed conversions $ 7,415 6,747 $ 1.10 ======= ======= ====== 59 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE H - (continued) Year Ended December 31, 2002 (In thousands, except per share data) -- Income Shares Per share (numerator) (denominator) amount ---------------- ------------------ ------------- Basic earnings per share Net income available to common stockholders $ 5,597 6,876 $ .81 Effect of dilutive securities Options -- 33 .-- ------- ------- ----- Diluted earnings per share Net income available to common stockholders plus assumed conversions $ 5,597 6,909 $ .81 ======= =======

====== Options to purchase 115,375 shares of common stock for $30.00 to $38.00 per share were outstanding during the year ended December 31, 2002. These options were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price for the Company's common stock during this period. NOTE I - INCOME TAXES The components of income tax expense are as follows: Years Ended December 31, -- 2004 2003 2002 ---- ---- ---- Current $ 6,515,000 $ 5,848,000 $ 4,216,000 Deferred Taxes (Benefit) (381,000) (204,000) 133,000 ----------- ----------- ----------- $ 6,134,000 $ 5,644,000 $ 4,349,000 =========== =========== =========== A reconciliation of the provision for income taxes for the years ended December 31, 2004, 2003 and 2002 and the amount computed by applying the statutory Federal income tax rate to income from continuing operations follows: Years Ended December 31, -- 2004 2003 2002 ---- ---- ---- Effective Tax Reconciliation Tax at statutory rate $ 4,636,000 $ 4,439,000 $ 3,381,000 State and City, net of federal income tax benefit 1,423,000 1,211,000 940,000 Tax exempt income -- (76,000) (53,000) Other 75,000 70,000 81,000 ----------- ----------- ----------- Actual provision for income taxes $ 6,134,000 $ 5,644,000 $ 4,349,000 =========== =========== =========== 60 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note I - (continued) The tax effect of the principal temporary differences at December 31, 2004 and 2003 are as follows: December 31, ----------------------------------- 2004 2003 ---- ---- Net deferred tax assets Loan loss provision $1,359,000 1,215,000 Depreciation 92,000 9,000 Other 234,000 80,000 Unrealized (gain) loss on investment securities 1,528,000 (500,000) ---------- ----------- Net deferred tax asset included in other assets $3,213,000 $ 804,000 ========== =========== NOTE J - STOCK PLANS In March 1999, the stockholder's of the Company approved the 1999 Stock Incentive Plan (the "1999 Stock Incentive Plan"). The 1999 Stock Incentive Plan permits the granting of awards in the form of nonqualified stock options, incentive stock options, restricted stock, deferred stock, and other stock-based incentives. Up to 600,000 shares of common stock of the Company may be issued pursuant to the 1999 Stock Incentive Plan. Officers, directors and other key employees of the Company or any subsidiary are eligible to receive awards under the 1999 Stock Incentive Plan. Options outstanding under the 1999 Stock Incentive Plan were 314,250 and 337,125 as of December 31, 2004 and 2003, respectively. As of December 31, 2004 and 2003, 50,834 options and 171,294 options, respectively, were also outstanding as a result of the GSB acquisition. The Company did not grant options in 2004, 2003 and 2002. A summary of activity with respect to the Stock Option Plan follows: December 31, -- 2004 2003 2002 -------------------------- -------------------------- -------------------------- Weighted Weighted Weighted Average Average Average Exercise Exercise Exercise Shares Price Shares Price Shares Price ------ ----- ------ ----- ------ ----- Outstanding at beginning of 508,419 $10.12 532,503 $10.10 574,788 $ 9.91 year Granted -- $ -- -- $ -- -- $ -- Cancelled (1,500) $10.00 -- $ -- (19,527) $ 9.04 Exercised (141,835) $ 8.95 (24,084) $ 8.61 (22,758) $ 7.25 -------- -------- -------- Outstanding at end of year 365,084 $10.65 508,419 $10.12 532,503 $10.10 ======== ======== ======== Exercisable at end of year 365,084 $10.65 497,394 $10.16 502,500 $11.03 ======== ======== ======== Weighted average fair value of options granted during the year $ -- $ -- $ -- ====== ====== ====== 61 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note J - (continued) The following table summarizes information about options outstanding at December 31, 2004: Options Outstanding Options Exercisable --- --------------------------- Number Weighted Number outstanding average Weighted outstanding Weighted at remaining average at average Range of December 31, contractual exercise December 31, exercise exercise prices 2004 life (years) price 2004 price --------------- ------ ------------ ------- ------ ------ $ 5.98 - 8.78 50,834 3.21 $ 8.53 50,834 $ 8.53 10.00 - 12.67 314,250 1.53 10.99 314,250 10.99 -------- -------- 365,084 365,084 ======== ======== NOTE K - EMPLOYEE BENEFIT PLANS 1. Retirement Income Plan The Company has a Retirement Income Plan (the "Retirement Plan"), a noncontributory plan covering substantially all full-time, non-union United States employees of the Company. Benefits were based upon a combination of employee compensation and years of service. The Company paid the entire cost of the plan for its employees and funded such costs as they accrued. The Company's funding policy was to make annual contributions within minimum and maximum levels required by applicable regulations. The Company's customary contributions were designed to fund normal cost on a current basis and fund over 30 years the estimated prior service cost of benefit improvements (15 years of annual gains and losses). The projected unit cost method was used to determine the annual cost. Benefit accruals were frozen as of September 15, 1988, resulting in a plan curtailment. As a result of such curtailment, the Company did not accrue benefits for future services; however, the Company did continue to contribute as necessary for any unfunded liabilities. In 2000, the Company reinstated the Retirement Plan to cover substantially all full-time, non-union United States employees of the Company. The following table summarizes the major categories of Plan assets as of the dates indicated: December 31, -- 2004 2003 ------------------------------- ------------------------------- Fair Value % of Total Fair Value % of Total -------------- --------------- -------------- -------------- (In thousands, except percentages Mutual Funds International Equity Fund $ 120 6.64% $ 127 6.99% Large Cap Equity Growth Fund 793 43.94 831 45.76 International Investment Grade Bond Fund 550 30.47 570 31.39 Small Cap Equity Growth Fund 118 6.54 122 6.72 Corporate Common Stocks(1) 216 11.97 157 8.65 Cash and cash equivalents 8 0.44 9 0.49 ------- ------ ------- ------ Total Plan Assets $ 1,805 100.00% $ 1,816 100.00% ---------- (1) Includes 4,500 shares of the Company's Common Stock with a market value of $92,250 and $75,000 at December 31, 2004 and 2003, respectively. 62 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note K - (continued) The assets of the plan are primarily invested in well diversified common stock and fixed income funds designed to minimize risk while maximizing expected portfolio returns. To achieve the long term rate of return, plan assets will be invested in a mixture of instruments, including but not limited to, corporate common stock, investment grade bond funds, small and large cap equity funds and international equity funds. The allocation of assets will be determined by the Investment Manager, and will typically include 50% to 70% equities, with the remainder invested in fixed income and a minimal amount of cash. Presently, this diversified portfolio is expected to return approximately 8.50% in the long run. The expected rate of return on plan assets was determined based upon a review of historical returns, both for our Retirement Plan and for medium to large-sized defined benefit pension funds with similar asset allocations. This review generated separate expected future long-term returns for each asset class listed in the above table. These expected future returns were then blended based upon our plan's target asset allocation. Assumptions Weighted-average assumptions used to determine benefit obligations were as follows at the dates indicated: December 31, ---------------------------- 2004 2003 ------------- ------------- Discount rate 5.75% 6.60% Rate of compensation increase 5.00% 5.00% Weighted-average assumptions used to determine net periodic benefit cost for the years ended December 31, 2004 and 2003 were as follows: December 31, ---------------------------- 2004 2003 ------------- ------------- Discount rate 6.60% 7.25% Rate of compensation increase 5.00% 5.00% Expected return on plan assets 8.50% 8.50% Measurement date 1/1/2004 1/1/2003 A summary of the components of net periodic pension cost for the years ended December 31, 2004, 2003 and 2002 is as follows: December 31, ------------------------------------- 2004 2003 2002 ---------- ----------- -------- Service cost-benefits earned during the period $ 243,916 $ 195,162 $ 48,883 Interest cost on projected benefit obligation 121,005 107,211 98,897 Expected return on plan assets (150,145) (123,482) (148,973) Net amortization and deferral 37,428 43,208 18,370 --------- --------- --------- Net pension cost of defined benefit plan $ 252,204 $ 222,099 $ 17,177 ========= ========= ========= 63 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE K - (continued) The following table sets forth the funded status and amounts recognized in the Company's balance sheet for its defined benefit plan at December 31, 2004 and 2003: December 31, -- 2004 2003 ------------------- ------------------- Actuarial present value of vested accumulated benefit obligations $ 2,316,075 $ 1,807,366 Actuarial present value of accumulated benefit obligations 2,316,075 1,814,032 ----------- ----------- Projected benefit obligations $(2,316,075) $(1,814,032) Fair value of plan assets 1,804,866 1,815,905 ----------- ----------- Excess of projected benefit obligation over fair value of plan assets (511,209) 1,873 Unrecognized prior service cost 139,244 157,614 Unrecognized net loss 597,925 318,677 ----------- ----------- Prepaid pension cost, included in other assets $ 225,960 $ 478,164 =========== =========== Estimated Future Benefit Payments We estimate future benefit payments to be as follows: Benefit Years Payments ----- -------- 2005 139,230 2006 144,405 2007 176,105 2008 161,432 2009 263,881 Years 2010-2014 1,042,795 Company Contributions During the fiscal year ending December 31, 2005, the Company expects to contribute approximately $58,000 to its Retirement Plan. 64 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE K - (continued) 2. Former Goshen Bank Pension Plan The Bank, as successor to Goshen Bank, had a non-contributory defined benefit pension plan covering substantially all of its employees. In the fourth quarter of 2000, the Goshen Bank froze its defined benefit pension plan and provided that there would be no further accruals under the plan. On October 24, 2002, the Board of Directors of the Bank approved the termination of this plan. In 2003, we paid out approximately $600,000 to complete the termination of this plan and purchase annuity contracts. Upon the notice of termination, all participant benefits vest 100%. December 31, 2002

-------------------- Change in benefit obligation (In thousands) Benefit obligation at beginning of year $ 1,193 Service cost -- Interest cost 84 Actual loss 85 Benefits paid (91) -------- Benefits obligations at end of year 1,271 Change in plan assets Fair value of plan assets at beginning of year 1,309 Actual return on plan assets (917) Employer contribution -- Benefits paid (91) -------- Fair value of plan assets at end of year 1,127 Funded status (144) Unrecognized net actuarial loss 340 -------- Prepaid benefit cost (included in other assets) $ 196 ======== Net pension cost included the following components: Year Ended December 31, -- 2004 2003 2002 ------------ ------------ ------------- (In thousands) Service cost $ -- $ -- $ -- Interest cost on projected benefit obligation -- -- 84 Expected return on plan -- -- (88) assets Purchase accounting change -- -- -- ------- ------- ------- Net periodic benefit cost $ -- $ -- $ 4 ======= ======= ======= The assumed discount rate and rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation was 7.25% in 2002. 65 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE K - (continued) 3. Postretirement Welfare Plan In addition to pension benefits, the Bank, as successor to Goshen Bank provides certain health care and life insurance benefits for retired employees and their spouses. The postretirement health care and life insurance benefits plan was terminated for persons retiring after December 31, 1998. Eligible employees retired on or before that date will have benefits paid through the plan under the agreed upon terms existing at the employee's retirement date. December 31, ------------------------------ 2004 2003 ----------- ------------- (In thousands) Change in benefit obligation Benefit obligation at beginning of year $ 715 $ 718 Service cost -- -- Interest cost 43 47 Actual loss 10 2 Benefits paid (49) (52) -------- -------- Benefits obligation at end of year 719 715 -------- -------- Change in plan assets Fair value of plan assets at beginning of year -- -- Actual return on plan assets -- -- Employer contribution 49 52 Benefits paid (49) (52) -------- -------- Fair value of plan assets at end of year -- -- -------- -------- Funded status (719) (715) Unrecognized net actuarial loss 25 15 -------- -------- Accrued benefit cost (included in other liabilities) $ 694 $ 700 ======== ======== Net benefit cost included the following components: Year Ended December 31, -------------------------------------- 2004 2003 ------------------ ------------------ (In thousands) Service cost $ -- $ -- Interest cost on projected benefit obligation 43 47 Actual return on plan assets -- -- -------- -------- Net periodic benefit cost $ 43 $ 47 ======== ======== The assumed discount rate used in determining the actuarial present value of the projected benefit obligation was 6.125% and 6.75% in 2004 and 2003, respectively. 66 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE K - (continued) 4. 401(k) Plans The Bank has a 401(k) plan in which employees can contribute up to 15% of their salary. The Bank also matches 50% of the employee contribution up to a maximum of 3% of the employee's salary. The matching expense was $89,000, $76,000 and $105,000 for the years ended December 31, 2004, 2003 and 2002, respectively. 5. Deferred Compensation Arrangements GSB Financial and Goshen Bank established deferred compensation arrangements for certain directors and executives. These deferred compensation arrangements were terminated as a result of the acquisition. At December 31, 2004 and 2003, the balance accumulated under these arrangements was approximately $241,000 and will be paid out when the individual (i) ceases to be a director and/or executive of the Company; (ii) attains the age of 75; or (iii) specifies a particular date. NOTE L - COMMITMENTS AND CONTINGENCIES 1. Leases and Other Commitments The Company leases certain of its operating facilities under non-cancelable operating leases expiring in 2005 through 2012. The leases require payment by the Company of the real estate taxes and insurance on the leased properties. Approximate future minimum annual rental payments are as follows: Year Ending (In thousands) December 31, ------------------- 2005 $ 712 2006 713 2007 727 2008 537 2009 475 Thereafter 531 ------- $ 3,695 ======= Rental expense was approximately $964,000, $699,000 and $811,000 for the fiscal years ended December 31, 2004, 2003 and 2002, respectively. Included in rental expense was approximately $298,000, $270,000 and $255,000 for the fiscal years ended December 31, 2004, 2003 and 2002, respectively, which was paid to a company affiliated with a director of the Company. NOTE M - FAIR VALUE OF FINANCIAL INSTRUMENTS SFAS No. 107 requires disclosure of the estimated fair value of an entity's assets and liabilities considered to be financial instruments. For the Company, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments as defined in SFAS No. 107. However, many such instruments lack an available trading market, as characterized by a willing buyer and seller engaging in an exchange transaction. Also, it is the Company's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities, except for certain loans. Therefore, the Company had to use significant estimations and present value calculations to prepare this disclosure. 67 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to

Consolidated Financial Statements (continued) Note M - (continued) Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Also, management is concerned that there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values. Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. The estimation methodologies used, the estimated fair values, and recorded book balances at December 31, 2004 and 2003 are outlined below. For cash and cash equivalents, the recorded book values of $17.38 million and $9.31 million at December 31, 2004 and 2003, respectively, approximate fair values. The estimated fair values of investment securities are based on quoted market prices, if available. Estimated fair values are based on quoted market prices of comparable instruments if quoted market prices are not available. December 31, --- 2004 2003 ------------------------------- ----------------------------------- Carrying Estimated Carrying Estimated amount fair value amount fair value ------------- -------------- ---------------- ---------------- (In thousands) Investment securities $631,592 $631,601 $569,848 $569,852 Loans, net of unearned income 286,979 291,460 294,756 301,647 Time Deposits 274,309 273,397 317,480 318,450 Repurchase Agreements 127,747 127,442 114,391 114,462 Long-term Debt 111,069 112,598 77,745 81,053 The net loan portfolio at December 31, 2004 and 2003 has been valued using a present value discounted cash flow where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk. The carrying value of accrued interest approximates fair value. The estimated fair values of demand deposits (i.e. interest (checking) and non-interest bearing demand accounts, savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The carrying amount of accrued interest payable approximates its fair value. The fair value of commitments to extend credit is estimated based upon the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based upon the amount of unearned fees plus the estimated cost to terminate letters of credit. Fair values of unrecognized financial instruments, including commitments to extend credit, and the fair value of letters of credit are considered immaterial. The fair value of interest rate caps are based upon the estimated amount the Company would receive or pay to terminate the contracts or agreements, taking into account current interest rates and, when appropriate, the current creditworthiness of the counterparties. The aggregate fair value for the interest rate caps were approximately $132,000 and $180,000 at December 31, 2004 and 2003, respectively. 68 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE N - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK AND CONCENTRATIONS OF CREDIT RISK The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of their customers. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Banks have in particular classes of financial instruments. The Bank'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 or notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as they do for on-balance-sheet instruments. Unless noted otherwise, the Bank does not require collateral or other security to support financial instruments with credit risk. The approximate contract amounts are as follows: December 31, ----------------------------------- 2004 2003 -------------- --------------- (In thousands) Unused lines of credit $ 15,859 $ 11,243 Commitments to extend credit -- 2,011 Standby letters of credit and financial guarantees written 750 775 ------- -------- $ 16,609 $ 14,029 ======== ======== Interest rate caps-notional amount $ 25,000 $ 30,000 ======== ======== Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds residential or commercial real estate, accounts receivable, inventory and equipment as collateral supporting those commitments for which collateral is deemed necessary. The extent of collateral held for those commitments at December 31, 2004 varies up to 100%. The Company defines the initial fair value of these letters of credit as the fee received from the customer. The maximum potential undiscounted amount of future payments of these letters of credit as of December 31, 2004 are $750,000 and they expire through 2006. Amounts due under these letters of credit would be reduced by any proceeds that the Company would be able to obtain in liquidating the collateral for the loans, which varies depending on the customer. 69 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE N - (continued) The Bank grants loans primarily to customers in New York and its immediately adjacent suburban communities. Although the Bank has a diversified loan portfolio, a large portion of their loans are secured by commercial or residential real property. The Bank does not generally engage in non-recourse lending and typically will require the principals of any commercial borrower to obligate themselves personally on the loan. Although the Bank has diversified loan portfolios, a substantial portion of their debtors' ability to honor their contracts is dependent upon the economic sector. Commercial and standby letters of credit were granted primarily to commercial borrowers. The Bank has entered into interest rate cap agreements in order to hedge its exposure to interest rate fluctuations. The Company adopted the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), as amended, as of January 1, 2001. The statement requires the Company to recognize all derivative instruments at fair value as either assets or liabilities. Financial derivatives are reported at fair value in other assets or other liabilities. For derivatives not designated as hedges, the gain or loss is recognized in current earnings. Amounts reclassed into earnings, when the hedged transaction culminates, are included in interest income. NOTE O - REGULATORY MATTERS The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possible additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes that, as of December 31, 2004, the Bank meets all capital adequacy requirements to which it is subject. As of December 31, 2004, the Bank met all regulatory requirements for classification as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since that date that management believes have changed the institution's category. 70 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) Note O - (continued) The following table sets forth the actual and required regulatory capital amounts and ratios of, the Company and the Bank as of December 31, 2004 and 2003 (dollars in thousands): To be well capitalized under For capital prompt corrective Actual adequacy purposes action provisions ------ ---------------- ---------------- Amount Ratio Amount Ratio Amount Ratio ------ ----- ------ ----- ------ ----- December 31, 2004 Total Capital (to Risk-Weighted Assets) Company 110,063 30.1% 29,234 >=8.0% -- N/A Bank 82,970 24.1% 27,533 >=8.0% 34,416 >=10.0% Tier I Capital (to Risk-Weighted Assets) Company 107,136 29.3% 14,617 >=4.0% -- N/A Bank 80,042 23.3% 13,766 >=4.0% 20,649 >=6.0% Tier I Capital (to Average Assets) Company 107,136 11.2% 38,250 >=4.0% -- N/A Bank 80,042 8.6% 37,240 >=4.0% 46,550 >=5.0% To be well capitalized under For capital prompt corrective Actual adequacy purposes action provisions ------ ---------------- ---------------- Amount Ratio Amount Ratio Amount Ratio ------ ----- ------ ----- ------ ----- December 31, 2003 Total Capital (to Risk-Weighted Assets) Company 86,759 26.1% 26,630 >=8.0% -- N/A Bank 60,675 19.1% 25,417 >=8.0% 31,772 >=10.0% Tier I Capital (to Risk-Weighted Assets) Company 84,166 25.3% 13,315 >=4.0% -- N/A Bank 58,082 18.3% 12,709 >=4.0% 19,063 >=6.0% Tier I Capital (to Average Assets) Company 84,166 10.7%

31,410 >=4.0% -- N/A Bank 58,082 7.0% 33,391 >=4.0% 41,739 >=5.0% 71 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE P - CONDENSED FINANCIAL INFORMATION - PARENT COMPANY ONLY The condensed financial information for Berkshire Bancorp Inc. (parent company only) is as follows: CONDENSED BALANCE SHEETS (In Thousands) December 31, ------------------------------- 2004 2003 ------------ ------------ ASSETS Cash $ 7,415 $ 12,035 Equity investment in subsidiaries 101,004 82,532 Investment in securities available for sale 9,022 2,901 Loans 6,059 6,244 Accrued interest receivable 284 74 Other assets 892 499 --------- --------- Total assets $ 124,676 $ 104,285 ========= ========= LIABILITIES AND STOCKHOLDERS' EQUITY Subordinated debt $ 15,464 $ -- Other liabilities 1,593 795 --------- --------- Total liabilities 17,057 795 --------- --------- Stockholders' equity Common stock 770 256 Additional paid-in capital 89,543 89,866 Retained earnings 28,983 22,960 Accumulated other comprehensive income, net (2,602) 775 Common stock in treasury, at cost (9,075) (10,367) --------- --------- Total stockholders' equity 107,619 103,490 --------- --------- $ 124,676 $ 104,285 ========= ========= 72 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE P - (continued) CONDENSED STATEMENTS OF INCOME (In Thousands) For The Years Ended December 31, -------------------------------------- 2004 2003 2002 -------- -------- -------- INCOME Interest income from the Bank $ 71 $ 106 $ 207 Interest income 1,090 795 1,149 Gain on sales of 734 1,131 7 investment securities Other income (loss) 96 407 (73) -------- -------- -------- Total income 1,991 2,439 1,290 EXPENSES Salaries and employee benefits 489 442 243 Interest expense 463 -- -- Other expenses 1,058 759 505 -------- -------- -------- Total expenses 2,010 1,201 748 -------- -------- -------- Income (loss) before income taxes and equity in undistributed net income of the Bank (19) 1,238 542 Equity in undistributed net income of the Bank 7,668 6,710 5,405 -------- -------- -------- Income before taxes 7,649 7,948 5,947 Provision for income taxes 147 533 350 -------- -------- -------- Net income $ 7,502 $ 7,415 $ 5,597 ======== ======== ======== 73 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE P - (continued) CONDENSED STATEMENTS OF CASH FLOWS (In Thousands) For The Years Ended December 31, -- 2004 2003 2002 ------ ------ ----- Operating activities: Net income $ 7,502 $ 7,415 $ 5,597 Adjustments to reconcile net income to net cash provided by (used in) operating activities: Gain on sales of investment securities (734) (1,131) (7) Equity in undistributed net income of the Bank (7,668) (6,843) (5,405) Dividends received from the Bank 500 -- -- Increase in other liabilities 798 294 214 Decrease in other assets 69 151 840 -------- -------- -------- Net cash provided by (used in) operating activities 467 (114) 1,239 -------- -------- -------- Investing activities: Investment securities available for sale Purchases (9,150) (5,172) (2,965) Sales 3,874 9,451 775 Net decrease (increase) in loans 185 2,176 (1,942) Contribution to the Bank (14,791) -- -- Transfer of premises and equipment -- -- (1,292) -------- -------- -------- Net cash provided by (used in) investing activities (19,882) 6,455 (5,424) -------- -------- -------- Financing activities: Proceeds from exercise of common stock options 1,271 205 102 Acquisition of treasury stock (69) (1,350) (4,422) Cash paid for fractional shares (463) -- -- Issuance of subordinated debentures 14,791 -- -- Dividends paid (735) (600) (505) -------- -------- -------- Net cash provided by (used in) financing activities 14,795 (1,745) (4,825) -------- -------- -------- Net increase (decrease) in cash and cash equivalents (4,620) 4,596 (9,010) Cash and cash equivalents at beginning of year 12,035 7,439 16,449 -------- -------- -------- Cash and cash equivalents at end of year $ 7,415 $ 12,035 $ 7,439 ======== ======== ======== Supplemental disclosures of cash flow information: Cash used to pay interest $ 273 $ -- $ -- Cash used to pay income taxes $ 419 $ 375 $ 146 Transfer of premises and equipment to subsidiary for note receivable $ -- $ 5,056 $ -- 74 BERKSHIRE BANCORP INC. AND SUBSIDIARIES Notes to Consolidated Financial Statements (continued) NOTE Q - QUARTERLY FINANCIAL DATA (UNAUDITED) The following represents summarized quarterly financial data of the Company which, in the opinion of management, reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the Company's results of operations. (In thousands, except per share data). Three Months Ended --- March 31 June 30 September 30 December 31 ---------- ---------- ------------ ----------- 2004 ---- Interest income $ 9,638 $ 9,626 $ 10,276 $ 10,468 Interest expense (3,720) (3,796) (4,103) (4,297) -------- -------- -------- -------- Net interest income 5,918 5,830 6,173 6,171 Provision for loan losses (45) (45) (45) (45) Gains on sales of securities 93 49 173 478 Non-interest income 325 202 282 217 Non-interest expenses (2,962) (3,172) (3,126) (2,835) -------- -------- -------- -------- Income before taxes 3,329 2,864 3,457 3,986 Provision for taxes (1,378) (1,383) (1,489) (1,884) -------- -------- -------- -------- Net income $ 1,951 $ 1,481 $ 1,968 $ 2,102 ======== ======== ======== ======== Per share data Net income per common share

Basic $ .29 $ .22 $ .30 $ .31 ======== ======== ======== ======== Diluted $ .28 $ .22 $ .30 $ .30 ======== ======== ======== ======== Three Months Ended -- March 31 June 30 September 30 December 31 ---------- ---------- ------------ ----------- 2003 ---- Interest income $ 8,378 $ 8,480 $ 8,621 $ 8,947 Interest expense (3,388) (3,395) (3,332) (3,532) -------- -------- -------- -------- Net interest income 4,990 5,085 5,289 5,415 Provision for loan losses (105) (45) (45) (45) Gains on sales of securities 628 1,491 183 444 Non-interest income 364 305 297 271 Non-interest expenses (2,712) (2,727) (3,093) (2,931) -------- -------- -------- -------- Income before taxes 3,165 4,109 2,631 3,154 Provision for taxes (1,423) (1,801) (1,223) (1,197) -------- -------- -------- -------- Net income $ 1,742 $ 2,308 $ 1,408 $ 1,957 ======== ======== ======== ======== Per share data Net income per common share Basic $ .26 $ .35 $ .21 $ .30 ======== ======== ======== ======== Diluted $ .26 $ .34 $ .21 $ .29 ======== ======== ======== ======== 75 ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure. Not Applicable. ITEM 9A. Controls and Procedures Evaluation of the Company's Disclosure Controls and Internal Control. As of the end of the period covered by this Annual Report on Form 10-K, the Company evaluated the effectiveness of the design and operation of its "disclosure controls and procedures" as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 ("Disclosure Controls"). This evaluation ("Controls Evaluation") was done under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") who is also the Chief Financial Officer ("CFO"). Limitations on the Effectiveness of Controls. The Company's management, including the CEO/CFO, does not expect that its Disclosure Controls and/or its "internal control over financial reporting" as defined in Rule 13(a)-15(f) of the Securities Exchange Act of 1934 ("Internal Control") will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. 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 management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Conclusions. Based upon the Controls Evaluation, the CEO/CFO has concluded that, subject to the limitations noted above, the Disclosure Controls are effective in reaching a reasonable level of assurance that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time period specified in the Securities and Exchange Commission's rules and forms. In accordance with SEC requirements, the CEO/CFO notes that during the fiscal quarter ended December 31, 2004, no changes in Internal Control have occurred that have materially affected or are reasonably likely to materially affect Internal Control. ITEM 9B. Other Information Not Applicable 76 PART III ITEM 10. Directors and Executive Officers of the Registrant. The following are the current directors and executive officers of the Company: Name Age Position(s) ---- --- -------------------------- Steven Rosenberg 56 President, Director William L. Cohen 63 Director Thomas V. Guarino 51 Director Moses Marx 69 Director Randolph B. Stockwell 58 Director Moses Krausz 64 President of The Berkshire Bank David Lukens 55 Executive Vice President, Chief Financial Officer of The Berkshire Bank Mr. Rosenberg has served as President and Chief Executive Officer of the Company since March 1999 and as Vice President and Chief Financial Officer of the Company from April 1990 to March 1999. He continues to serve as Chief Financial Officer. Mr. Rosenberg was elected a director in May 1995. From September 1987 through April 1990, he served as President and Director of Scomel Industries, Inc., a company engaged in international marketing and consulting. Mr. Rosenberg is a director of The Cooper Companies, Inc. (a developer and manufacturer of healthcare products). Mr. Cohen was elected a director in July 1993. He has served as the Chief Executive Officer of Andover Properties, LLC, a real estate development company specializing in self storage facilities since November 2003, and has been a private investor for over six years. Mr. Cohen served as President, Chief Executive Officer and Chairman of the Board of The Andover Apparel Group, Inc., an apparel manufacturing company, from 1980 to 2000. Mr. Guarino was elected a director in March

2001. He served as a director of Goshen Savings Bank from 1996, and chairman of the Board of Directors of GSB Financial Corporation from April 1998, until the respective mergers of those companies into The Berkshire Bank and the Company in March 2001. Mr. Guarino is the President and Senior Portfolio Manager of the Hudson Valley Investment Advisors, Inc., an investment management and advisory company, a position he has held since 1995. Prior to that, he had been, since 1988, a Vice President of Fleet Investment Advisors, Inc. and was Vice President in charge of investments of Norstar Bank of the Hudson Valley from 1981 to 1988. Mr. Marx was elected a director in May 1995. Mr. Marx has been the General Partner in United Equities Company since 1954 and General Partner in United Equities Commodities Company since 1972. He is also President of Momar Corp. All of these are investment companies. Mr. Marx is a director of The Cooper Companies, Inc. Mr. Stockwell was elected a director in July 1988. He has been a private investor for over ten years. Since April 1999, Mr. Stockwell has served as President of Yachting Systems of America, LLC, a small start-up company. In addition, he served in various capacities with the Community Bank, a commercial bank, from September 1972 to January 1987. Mr. Krausz has held the position of President of The Berkshire Bank since March 1992 and Chief Executive Officer since November 1993. Prior to joining The Berkshire Bank, Mr. Krausz was Managing Director of SFS Management Co., L.P., a mortgage banker, from 1987 to 1992 and was President of UMB Bank and Trust Company, a New York State chartered bank, from 1978 to 1987. Mr. Lukens has held the position of Senior Vice President and Chief Financial Officer of The Berkshire Bank since December 1999, Executive Vice President since December 2003. Prior to joining the Bank, Mr. Lukens was Senior Vice President and Chief Financial officer of First Washington State Bank, a New Jersey commercial bank, from 1994 to 1999 and was Vice President and Controller at the Philadelphia, PA branch of Bank Leumi Le-Israel B.M., an international commercial bank, from 1978 to 1994. There are no family relationships (whether by blood, marriage or adoption) among any of the Company's current directors or executive officers. 77 Audit Committee Members, Financial Expert and Independence The Board of Directors of the Company has established an Audit Committee comprised of three independent directors, Messrs. William L. Cohen, Thomas V. Guarino and Randolph B. Stockwell. All of the members of the Audit Committee meet the independence requirements under current NASDAQ corporate governance standards for companies whose securities are quoted on NASDAQ. Based upon their education and relevant experience, the Board of Directors has determined that Messrs. Guarino and Stockwell each qualify as financial experts as defined by the Sarbanes-Oxley Act of 2002 and the rules of the Securities and Exchange Commission. Corporate Code of Ethics We have adopted a Corporate Code of Ethics that applies to the directors, officers and employees, including the senior management: the chief executive officer, chief financial officer, controller and persons performing similar functions, of Berkshire Bancorp Inc. and its subsidiaries. Copies of our Corporate Code of Ethics are available without charge upon written request to the Company at its principal executive office. ITEM 11. Executive Compensation The following table shows the compensation paid in or with respect to each of the last three fiscal years to the individual who served as the Company's Chief Executive Officer for the fiscal year ended December 31, 2004, and to each of the other executive officers who were paid more than $100,000 during the fiscal year ended December 31, 2004. Summary Compensation Table Annual Compensation ------------------- Name and Principal Position All Other -------------------------- Year Salary Bonus Compensation ---- ------ ----- ------------ Steven Rosenberg 2004 $182,000 $ 10,000 $ -- President, Chief Executive 2003 $175,500 $ -- $ -- Officer and Chief Financial 2002 $167,500 $ -- $ -- Officer Moses Krausz 2004 $382,865 $200,000 $ 11,405(1) President and Chief Executive 2003 $358,864 $175,000 $ 10,405(1) Officer of The Berkshire Bank 2002 $347,288 $175,000 $ 10,050(1) David Lukens 2004 $155,000 $ 25,000 $ 7,350(2) Executive Vice President and 2003 $138,500 $ 25,000 $ 5,968(2) Chief Financial Officer of 2002 $125,000 $ 24,000 $ 5,367(2) The Berkshire Bank ---------- (1) Consists of contributions by the Company to a 401(k) account of $8,000, $7,000 and $6,000, respectively, in 2004, 2003 and 2002, and income associated with life insurance coverage in excess of $50,000. (2) Consists of contributions by the Company to a 401(k) account of $5,205, $4,905 and $4,470, respectively, in 2004, 2003 and 2002, and income associated with life insurance coverage in excess of $50,000. Does not include the annual retirement credits of 5% of gross wages under the Company's Retirement Income Plan. 78 Option Grants in Last Fiscal Year There were no stock option grants during the fiscal year ended December 31, 2004. Aggregated Option Exercises and Fiscal Year-End Option Values The following table sets forth information concerning options exercised during the fiscal year ended December 31, 2004, and the number of options owned and the value of any in-the-money unexercised options as of December 31, 2004 by each of the individuals named in the Summary Compensation Table. Number of Unexercised Shares Options at Acquired Fiscal Year-End Value of Unexercised on Value (#) In-the-Money Options at Exercise

Realized Exercisable Fiscal Year-End ($) Name (#) ($) /Unexercisable Exercisable/Unexercisable ---- ----- ----- ------------- ------------------------ Steven Rosenberg -0- -0- 30,000/0 315,000/0 Moses Krausz -0- -0- 150,000/0 1,334,700/0 David Lukens -0- -0- 30,000/0 306,300/0 ---------- Year-end values for unexercised in-the-money options represent the positive spread between the exercise price of such options and the fiscal year end market value of the common stock. An Option is "in-the-money" if the fiscal year end fair market value of the Common Stock exceeds the option exercise price. Compensation of Directors Each director who is not also an employee of the Company (a "Non-Employee Director") receives a stipend of $18,000 per annum and $1,500 for each day during which he participates in a meeting of the Board or a Committee of the Board. Each Non-Employee Director also receives a fee of $1,000 for telephonic meetings of the Board or a Board Committee. In addition, see "1999 Stock Incentive Plan" below. 1999 Stock Incentive Plan The 1999 Stock Incentive Plan permits the granting of awards in the form of nonqualified stock options, incentive stock options, restricted stock, deferred stock, and other stock-based incentives. Up to 600,000 shares of common stock of the Company may be issued pursuant to the 1999 Stock Incentive Plan (subject to appropriate adjustment in the event of changes in the corporate structure of the Company). Officers, directors and other key employees of the Company or any subsidiary are eligible to receive awards under the 1999 Stock Incentive Plan. The option exercise price of all options which are granted under the 1999 Stock Incentive Plan must be at least equal to 100% of the fair market value of a share of common stock of the Company on the date of grant. At December 31, 2004, options to acquire 560,757 shares of common stock have been granted under this plan and 39,243 options are available for future grants. Retirement Income Plan The Company has a Retirement Income Plan (the "Retirement Plan"), a noncontributory plan covering substantially all full-time, non-union United States employees of the Company. Benefits were based upon a combination of employee compensation and years of service. The Company paid the entire cost of the plan for its employees and funded such costs as they accrued. The Company's funding policy was to make annual contributions within minimum and maximum levels required by applicable regulations. The Company's customary contributions were designed to fund normal cost on a current basis and fund over 30 years the estimated prior service cost of benefit improvements (15 years of annual gains and losses). The projected unit cost method was used to determine the annual cost. Plan assets consist principally of equity and fixed income mutual funds. 79 Benefit accruals were frozen as of September 15, 1988, resulting in a plan curtailment. As a result of such curtailment, the Company did not accrue benefits for future services; however, the Company did continue to contribute as necessary for any unfunded liabilities. In 2000, the Company reinstated the Retirement Plan to cover substantially all full-time, non-union United States employees of the Company. A participant in the Plan accumulates a balance in his or her retirement account by receiving: (i) an annual retirement credit of 5% of gross wages paid during the year, but not in excess of the applicable annual maximum compensation permitted to be taken into account under Internal Revenue Service guidelines for each year of service; and (ii) an annual interest credit based upon the 30-year U. S. Treasury securities rate. The Company pays the entire cost of the Plan for its employees and funds such costs as they accrue. The estimated annual benefits payable under the Plan upon retirement (at the normal retirement age of 65) for Messrs. Rosenberg and Lukens are approximately $160,000 and $16,000, respectively. In accordance with the laws currently governing the Plan, the estimated annual benefit payable to Mr. Rosenberg is not expected to increase. Mr. Krausz is not a participant in the Plan. (see Note K of Notes to Consolidated Financial Statements). ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Equity Compensation Plans. The following table sets forth certain information as of March 24, 2005 with respect to the beneficial ownership of the Company's Common Stock by (i) each person who is known by the Company to own beneficially more than 5% of the Company's Common Stock, (ii) each of the Company's directors and executive officers, and (iii) all executive officers and directors as a group. Number of Percent Shares of Class --------------- ------------- William Cohen 7,500 (1) * Thomas V. Guarino 99,370 (2) 1.5% Moses Krausz 238,000 (3) 3.4% David Lukens 30,600 (4) * Moses Marx 3,560,693 (5) 52.7% 160 Broadway New York, NY 10038 Steven Rosenberg 62,580 (6) * Randolph B. Stockwell 24,000 (7) * All executive officers and directors as a group (7 persons) 4,022,743 (8) 57.3% ---------- * Less than 1% (1) Includes 3,000 shares issuable upon the exercise of options which have been granted to Mr. Cohen under the Company's 1999 Stock Incentive Plan. (2) Includes 43,650 shares issuable upon the exercise of options which have been granted to Mr. Guarino under the Company's 1999 Stock Incentive Plan. Includes 7,920 shares held in trust for minor children and 900 shares held by Mr. Guarino's wife (3) Includes 150,000 shares issuable upon the exercise of options which have been granted to Mr. Krausz under the Company's 1999 Stock Incentive Plan and 2,100 shares owned by Mr. Krausz's spouse. (4) Includes 30,000 shares issuable upon the exercise of options which have been granted to Mr. Lukens under the Company's 1999 Stock Incentive Plan. 80 ITEM 12. (continued) (5) Includes 3,000 shares issuable upon the exercise of options which have been granted to Mr. Marx under the Company's 1999 Stock Incentive Plan, 285,000 shares owned by Momar Corporation and 391,163 shares owned by Terumah Foundation. Does not include 129,201 shares representing 80.5% of the shares owned by Eva and Esther, L.P., of which Mr. Marx has an 80.5% limited partnership interest. Mr. Marx's daughters and their husbands are the general partners of Eva and Esther, L.P. (6) Includes 30,000 shares issuable upon the exercise of options which have been granted to Mr. Rosenberg under the Company's 1999 Stock Incentive Plan. (7) Includes 3,000 shares issuable upon the exercise of options which have been granted to Mr. Stockwell under the Company's 1999 Stock Incentive Plan. (8) Includes 262,650 shares of Common Stock which are issuable upon the exercise of outstanding options. Equity Compensation Plans The following table details information regarding the Company's existing equity compensation plans as of December 31, 2004. (c) Number of securities (a) (b) remaining available for Number of securities to Weighted-average future issuance under be issued upon exercise exercise price of equity compensation plans of outstanding options, outstanding options, (excluding securities Plan Category warrants and rights warrants and rights reflected in column (a) ------------ ---------------------- -------------------- ----------------------- Equity compensation 365,084 $10.65 39,243 plans approved by security holders Equity compensation -- -- -- plans not approved by security holders Total 365,084 $10.65 39,243 ITEM 13. Certain Relationships and Related Transactions. In January 2000, the Bank entered into a lease agreement with Bowling Green Associates, LP, the principal owner of which is Mr. Marx, for commercial space to open a bank branch. The Company obtained an appraisal of the market rental value of the space from an independent appraisal firm and management believes that the terms of the lease, including the annual rent paid, $298,000 and $270,000 in fiscal 2004 and 2003, is comparable to the terms and annual rent that would be paid to non-affiliated parties in a similar commercial transaction for similar commercial space. See Item 1. Business - Transactions With Related Parties and Item 2. Properties for additional information. 81 ITEM 14. Principal Accountant Fees and Services The Company's principal accountant is Grant Thornton LLP ("Grant Thornton"). The total fees paid to Grant Thornton for the last two fiscal years are as follows: Fiscal Year Ended Fiscal Year Ended December 31, 2004 December 31, 2003 --------------------- ---------------------- Audit Fees $208,167 $146,153 Audit Related Fees: Professional services 16,250 6,815 rendered for employee benefit plan audits, accounting assistance in connection with acquisitions and consultations related to financial accounting and reporting standards Tax Fees: Tax consulting, preparation of 55,070 72,096 returns All Other Fees: Professional services 3,400 -- rendered for corporate support The Audit Committee has established its pre-approval policies and procedures, pursuant to which the Audit Committee approved the foregoing audit and permissible non-audit services provided by Grant Thornton LLP in 2004 and 2003. Consistent with the Audit Committee's responsibility for engaging our independent auditors, all audit and permitted non-audit services require pre-approval by the Audit Committee. The full Audit Committee approves proposed services and fee estimates for these services. The Audit Committee chairperson has been designated by the Audit Committee to approve any services arising during the year that were not pre-approved by the Audit Committee and services that were pre-approved. Service approved by the Audit Committee chairperson are communicated to the full Audit Committee at its next regular quarterly meeting and the Audit Committee reviews services and fees for the fiscal year at each such meeting. Pursuant to these procedures, the Audit Committee approved the foregoing audit and permissible non-audit services provided by Grant Thornton LLP. PART IV ITEM 15. Exhibits, Financial Statement Schedules. (a) Documents filed as part of this Report: (1) Financial Statements Report of Independent Registered Public Accounting Firm Consolidated Balance Sheets as of December 31, 2004 and 2003 Consolidated Statements of Income for the Years Ended December 31, 2004, 2003 and 2002 Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2004, 2003 and 2002 Consolidated Statements of Cash Flows for the Years Ended December 31, 2004, 2003 and 2002 Notes to Consolidated Financial Statements 82 ITEM 15. (continued) Schedule Number Description ------ ----------- None All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are not applicable and, therefore, have been omitted. (3) Exhibits Exhibit Number Description ------ ----------- 2.1 Agreement and Plan of Reorganization, dated as of August 16, 2000, by and between Berkshire Bancorp Inc., Greater American Finance Group, Inc., The Berkshire Bank, GSB Financial Corporation and Goshen Savings Bank (incorporated by reference to the Companies Registration Statement on Form S-4 dated October 13, 2000. 3.1 Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K dated March 30, 1999, and the Company's Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2004). 3.2 Amended and Restated By-laws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K dated March 30, 1999). 10.1 1999 Stock Incentive Plan of the Company (incorporated by reference to Exhibit 10.8 to the Company's Current Report on Form 8-K dated March 30, 1999).+ 10.2 Employment Agreement, dated May 1, 1999, between The Berkshire Bank and Moses Krausz (incorporated by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2000).+ 10.3 Employment Agreement, dated January 1, 2001, between The Berkshire Bank and David Lukens (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2000).+ 10.4 Lease Agreement, dated October 26, 1999, between Braun Management, Inc. as agent for Bowling Green Associates, L.P., and The Berkshire Bank (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the Quarterly Period Ended March 31, 2001). 10.5 Amendment No. 1 to Employment Agreement, dated August 1, 2001, by and between The Berkshire Bank and Moses Krausz (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the Quarterly Period Ended September 30, 2001).+ 10.6 Amendment No. 1 to Employment Agreement, dated June 3, 2002, by and between The Berkshire Bank and David Lukens (incorporated by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2002).+ 10.7 Amendment No. 2 to Employment Agreement, dated August 1, 2001, by and between The Berkshire Bank and Moses Krausz (incorporated by reference to Exhibit 10.8 to the Company's Quarterly Report on Form 10-Q for the Quarterly Period Ended June 30, 2002).+ 21. Subsidiaries of the Company. 23. Consent of Independent Registered Public Accounting Firm 31. Certification of Principal Executive and Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. 32. Certification of Principal Executive and Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ---------- + Denotes a management compensation plan or arrangement. 83 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. BERKSHIRE BANCORP INC. By: /s/ Steven Rosenberg ----------------------------------- Steven Rosenberg President, (Chief Executive Officer) Date: March 24, 2005 ----------------------------------- Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. Signature Title Date --------- ----- ---- President, (Chief Executive Officer, Principal Financial Officer and Principal Accounting Officer); /s/ Steven Rosenberg Director March 24, 2005 ------------------------ Steven Rosenberg /s/ William Cohen Director March 24, 2005 ------------------------ William Cohen /s/ Thomas V. Guarino Director March 24, 2005 ------------------------ Thomas V. Guarino /s/ Moses Marx Director March 24, 2005 ------------------------ Moses Marx /s/ Randolph B. Stockwell Director March 24, 2005 ------------------------- Randolph B. Stockwell 84 STATEMENT OF DIFFERENCES ----------------------- The greater-than-or-equal-to sign shall be expressed as................. >=