

Cornerstone Financial Corp
Form 10-Q/A
November 22, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

Amendment No. 1

x Quarterly report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2011

-OR-

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____.

CORNERSTONE FINANCIAL CORPORATION

(Exact name of registrant, as specified in its charter)

New Jersey

80-0282551

(State or other jurisdiction of incorporation
or organization)

(I.R.S. Employer
Identification No.)

6000 Midlantic Drive, Suite 120 S, Mount Laurel, New Jersey 08054

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(Address of principal executive offices)

Zip Code

Registrant's telephone number, including area code: (856) 439-0300

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

None

(Title of Class)

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

Common stock, no par value

(Title of Class)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO ___.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation SD-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES X NO ___.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

(Do not check if a smaller reporting company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) YES
☐ NO ☒

As of November 10, 2011, there were 1,954,428 outstanding shares of the registrant's Common stock.

Explanatory Note:

This amendment to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 ("Form 10-Q/A"), initially filed with the United States Securities and Exchange Commission on November 10, 2011, is being filed for the sole purpose of correcting certain clerical errors in the notes to the financial statements. No other changes have been made to the Quarterly Report on Form 10-Q and this amendment does not reflect events that may have occurred subsequent to the original filing time.

PART I. FINANCIAL INFORMATION

Item 1 – Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	September 30, 2011	December 31, 2010
(In thousands, except share data)		
Assets:	(unaudited)	
Cash and due from banks	\$ 6,297	\$ 5,331
Federal funds sold	40,400	3,700
Cash and cash equivalents	46,697	9,031
Investment securities:		
Held to maturity (fair value 2011 - \$22,569; 2010 - \$39,520)	21,929	40,435
Available for sale (amortized cost 2011- \$61,440; 2010 - \$47,945)	62,081	44,635
Loans receivable	244,286	242,856
Less allowance for loan losses	2,848	3,826
Loans receivable, net	241,438	239,030
Federal Home Loan Bank stock	1,438	1,435
Premises and equipment, net	7,693	7,806
Accrued interest receivable	1,815	2,152
Bank owned life insurance	4,806	4,685
Deferred taxes	557	2,600
Other real estate owned	830	830
Other assets	1,139	1,378
Total Assets	\$ 390,423	\$ 354,017
Liabilities:		
Non-interest bearing deposits	\$ 28,651	\$ 40,514
Interest bearing deposits	190,586	148,259
Certificates of deposit	110,506	113,497
Total deposits	329,743	302,270
Advances from the Federal Home Loan Bank	25,000	25,000
Line of credit	5,000	4,877
Subordinated debt	3,000	3,000
Other liabilities	1,388	1,122
Unsettled Security payable	5,250	-
	369,381	336,269

Total Liabilities

Commitments and Contingencies (Note 4)

Stockholders' Equity:

Preferred stock:

\$0 par value; \$1,000 per share stated value,
authorized 1,000,000 shares; issued and outstanding
1,900 at September 30, 2011 and December 31,
2010, respectively

1,900

1,900

Common stock:

\$0 par value: authorized 10,000,000 shares; issued
and outstanding 1,954,428 at September 30, 2011
and December 31, 2010, respectively

-

-

Additional paid-in capital

17,700

16,727

Accumulated other comprehensive income (loss)

385

(1,988)

Retained earnings

1,057

1,109

Total Shareholders' Equity

21,042

17,748

Total Liabilities and Shareholders' Equity

\$

390,423

\$

354,017

See accompanying notes to consolidated financial statements.

CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

Three Months Ended

(In thousands, except per share data)

	September 30, 2011 (Unaudited)	September 30, 2010 (Unaudited)
Interest Income		
Interest and fees on loans	\$ 3,295	\$ 3,460
Interest on investment securities	956	593
Interest on federal funds	3	16
Total interest income	4,254	4,069
Interest Expense		
Interest on deposits	915	991
Interest on borrowings	176	171
Total interest expense	1,091	1,162
Net interest income	3,163	2,907
Provision for loan losses	207	235
Net interest income after loan loss provision	2,956	2,672
Non-Interest Income		
Service charges on deposit accounts	46	50
Bank owned life insurance income	42	41
Gain on sale of loan	18	291
Gain on sale of securities	44	-
Miscellaneous fee income	44	30
Total non-interest income	194	412
Non-Interest Expense		
Salaries and employee benefits	1,453	1,231
Net occupancy	384	298
Data processing and other service costs	127	115
Professional services	173	322
Advertising and promotion	41	26
Other real estate owned expense	22	10
FDIC expense	31	131
Other operating expenses	188	161
Total non-interest expense	2,419	2,294
Income before income taxes	731	790
Income tax expense	282	311
Net income	449	479
Preferred stock dividends	33	33
Net income available to common shareholders		

Interest Income

	\$ 416	\$ 446
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Earnings per share

Basic	\$ 0.21	\$ 0.23(1)
Diluted	\$ 0.21	\$ 0.23(1)

Weighted average shares outstanding

Basic	1,954	1,954(1)
Diluted	1,954	1,978(1)

(1) All share and per share amounts have been restated to reflect the 8.0% common stock dividend paid on May 16, 2011 to

common shareholders of record as of April 15, 2011.

See accompanying notes to consolidated financial statements.

CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

Nine Months Ended

(In thousands, except per share data)	September 30, 2011 (Unaudited)	September 30, 2010 (Unaudited)
Interest Income		
Interest and fees on loans	\$ 9,939	\$ 10,248
Interest on investment securities	2,729	1,781
Interest on federal funds	9	24
Total interest income	12,677	12,053
Interest Expense		
Interest on deposits	2,752	2,932
Interest on borrowings	530	523
Total interest expense	3,282	3,455
Net interest income	9,395	8,598
Provision for loan losses	1,378	382
Net interest income after loan loss provision	8,017	8,216
Non-Interest Income		
Service charges on deposit accounts	136	148
Bank owned life insurance income	121	123
Gain on sale of loans	174	330
Gain on sale of securities	44	-
Miscellaneous fee income	161	85
Total non-interest income	636	686
Non-Interest Expense		
Salaries and employee benefits	4,191	3,648
Net occupancy	1,113	925
Data processing and other service costs	368	352
Professional services	501	609
Advertising and promotion	119	99
Other real estate owned expense	89	24
FDIC expense	286	355
Other operating expenses	506	476
Total non-interest expense	7,173	6,488
Income before income taxes	1,480	2,414
Income tax expense	563	939
Net income	917	1,475

Interest Income

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Preferred stock dividends	100	99
Net income available to common shareholders		
	\$ 817	\$ 1,376
<i>Earnings per share</i>		
Basic	\$ 0.42	\$ 0.70(1)
Diluted	\$ 0.42	\$ 0.70(1)
<i>Weighted average shares outstanding</i>		
Basic	1,954	1,954(1)
Diluted	1,958	1,967(1)

(1) All share and per share amounts have been restated to reflect the 8.0% common stock dividend paid on May 16, 2011 to

common shareholders of record as of April 15, 2011.

See accompanying notes to consolidated financial statements.

CORNERSTONE FINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS'

EQUITY

(Unaudited)

(In thousands, except per share data)

	Comprehensive Income	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance at							
December 31, 2010		\$ 1,900	\$-	\$ 16,727	\$ 1,109	\$ (1,988)	\$ 17,748
Comprehensive income							
Net income	\$ 917	-	-	-	917	-	917
Unrealized gain on securities available for sale, net of tax	2,373					2,373	2,373
Comprehensive income	\$ 3,290						
Stock based compensation		-	-	104	-	-	104
7 % Preferred stock dividend		-	-	-	(100)	-	(100)
Declaration of 8% common stock dividend		-	-	869	(869)	-	-
Balance at	\$	\$ 1,900	\$-	\$ 17,700	\$ 1,057	\$ 385	\$ 21,042

September 30,
2011

See accompanying notes to consolidated financial statements.

CORNERSTONE FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

Nine Months Ended

(In thousands)	September 30, 2011 (Unaudited)	September 30, 2010 (Unaudited)
Cash flows from operating activities:		
Net Income	\$ 917	\$ 1,475
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,378	382
Depreciation	328	293
Amortization of premiums and discounts, net	(120)	39
Stock option expense	104	101
Gain on sale of loans	(174)	-
Gain on sale of securities	(44)	-
Deferred tax expense(benefit)	465	(54)
Income on bank owned life Insurance	(121)	(123)
Decrease in accrued interest receivable and other assets	577	94
Increase in other liabilities	266	197
Net cash provided by operating activities	3,576	2,404
Cash flows from investing activities:		
Purchases of investments held to maturity	-	(44,509)
Purchases of securities available for sale	(26,309)	(28,519)
Repayment of investments available for sale	8,178	-
Repayment of investments held to maturity	18,511	48,320
Sale of investments available for sale	10,044	-
(Purchase) redemption of FHLB stock	(3)	137
Net increase in loans	(3,612)	(3,851)
Purchases of premises and equipment	(215)	(159)
Net cash provided (used) in investing activities	6,594	(28,581)
Cash flows from financing activities:		
Net increase in deposits	27,473	60,340
Proceeds from borrowings	10,123	242,753
Principal payments on borrowings	(10,000)	(247,483)
Cash dividend paid for preferred stock	(100)	(99)
Net cash provided by financing activities	27,496	55,511
Net increase in cash and cash equivalents	37,666	29,334
Cash and cash equivalents at the beginning of the period	9,031	4,742
Cash and cash equivalents at the end of the period	46,697	\$ 34,076
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	\$ 3,296	\$ 3,466

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Cash paid during the period for income taxes	96	991
Net change in unrealized gain on securities, net of tax	2,373	101
Supplemental non-cash investing and financing activities:		
Unsettled securities payable	\$ 5,250	\$ 4,000

See accompanying notes to consolidated financial statements.

CORNERSTONE FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Cornerstone Financial Corporation and its wholly owned subsidiary, Cornerstone Bank (together, the “Company”). These interim statements, which are unaudited, were prepared in accordance with instructions for Form 10-Q. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for fair presentation of the interim financial statements have been included.

Cornerstone Financial Corporation was formed in 2008 at the direction of the Board of Directors of Cornerstone Bank to serve as a holding company for the Bank. The holding company reorganization was completed in January 2009. The statement of financial condition as of December 31, 2010 has been derived from audited financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in Cornerstone Financial Corporation’s Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the United States Securities and Exchange Commission.

NOTE 2 – USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the allowance for loan losses and the evaluation of deferred taxes.

NOTE 3 - CONTINGENCIES

The Company, from time to time, is a party to routine litigation that arises in the normal course of business. Management does not believe the resolution of this litigation, either any individual case or in the aggregate, would have a material adverse effect on the Company's financial condition or results of operations. However, the ultimate outcome of any such matter, as with litigation generally, is inherently uncertain and it is possible that some of these matters may be resolved in a manner that is materially adverse to the Company.

NOTE 4 - EARNINGS PER SHARE

Basic earnings per share is calculated on the basis of net income divided by the weighted average number of shares outstanding. Diluted earnings per share includes dilutive potential common shares as computed under the treasury stock method using average common stock prices.

All share and per share amounts have been restated to reflect the 8.0% common stock dividend, declared on March 17, 2011, and paid on May 16, 2011 to common shareholders of record as of April 15, 2011. This stock dividend resulted in the issuance of 144,772 additional shares and resulted in \$869 thousand being transferred from retained earnings to additional paid in capital.

NOTE 5 – STOCK OPTIONS

The Company accounts for stock options in accordance with FASB Accounting Standards Codification (ASC) 718 *Stock Compensation*. The Company recognizes the grant-date fair-value of stock options and other equity-based compensation issued to employees in the statement of operations. The Company had \$159 thousand in unrecognized compensation costs relating to non-vested stock based compensation awards at September 30, 2011.

On July 16, 2009, options to purchase a total of 48,600 shares of common stock were granted with an exercise price of \$4.63 per share. These options will expire ten years from the date of the grant and vest on a one-third per year basis beginning on July 16, 2010, with vesting accelerating in certain circumstances such as change in control of the Company. The exercise price of each option equals the market price of the common stock on the date of the grant.

On January 16, 2010, options to purchase a total of 119,880 shares of common stock were granted with an exercise price of \$4.17 per share. These options will expire ten years from the date of the grant and vest on a one-third per year basis beginning on January 21, 2011, with vesting accelerating in certain circumstances such as change in control of the Company. The exercise price of each option equals the market price of the common stock on the date of the grant.

NOTE 6 - INVESTMENT SECURITIES

A comparison of amortized cost and approximate fair value of investment securities held to maturity at September 30, 2011 and December 31, 2010 is as follows (in thousands):

September 30, 2011					
	Cost	Gross Unrealized Gains	Gross Unrealized Losses		Fair Value
Investments held to maturity:					
Government agency obligations \$	14,982	\$ 163	\$ (10)	\$	15,135
Mortgage backed securities	6,947	487	-		7,434
Total	\$ 21,929	\$ 650	\$ (10)	\$	22,569

Investments available for sale:

Government agency obligations	\$	61,440		650	\$	(9)	\$	62,081
Total	\$	61,440	\$	650	\$	(9)	\$	62,081

December 31, 2010

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Investments held to maturity:				
Government agency obligations	\$ 32,706	\$ 68	\$ (1,131)	\$ 31,643
Mortgage backed securities	7,729	148	-	7,877
Total	\$ 40,435	\$ 216	\$ (1,131)	\$ 39,520

Investments available for sale:

Government agency obligations	\$	38,056	\$	-	\$	(2,496)	\$	35,560
US Treasury Securities		9,889		-		(814)		9,075
Total	\$	47,945	\$	-	\$	(3,310)	\$	44,635

The following table sets forth information regarding the fair value and unrealized losses on the Company's temporarily impaired

investment securities at September 30, 2011 and December 31, 2010 for the time periods shown (in thousands):

September 30, 2011						
	Less than 12 months Unrealized		12 months or longer		Total	
	Fair Value	Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Investments held to maturity:						
Government agency obligations	\$ 3,680	\$ (10)	\$ -	\$ -	\$ 3,680	\$ (10)
Investments available for sale:						
Government agency obligations	4,825	(9)	-	-	4,825	(9)
Total temporarily impaired investment securities	\$ 8,505	\$ (19)	\$ -	\$ -	\$ 8,505	\$ (19)
December 31, 2010						
	Less than 12 months Unrealized		12 months or longer		Total	
	Fair Value	Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Investments held to maturity:						
Government agency obligations	\$ 27,132	\$ (1,131)	\$ -	\$ -	\$ 27,132	\$ (1,131)
Investments available for sale:						
Government agency obligations	35,560	(2,496)	-	-	35,560	(2,496)
US Treasury Securities	9,075	(814)	-	-	9,075	(814)
Total temporarily impaired investment securities	\$ 71,767	\$ (4,441)	\$ -	\$ -	\$ 71,767	\$ (4,441)

Management has taken into consideration the following information in reaching the conclusion that the impairment of the securities listed in the table above is not other than temporary. The unrealized losses disclosed above are the result of fluctuations in market interest rates currently offered on like securities and do not reflect a deterioration or downgrade of the investment issuer's credit-worthiness or ability to meet its cash flow requirements. The Company believes that it is probable that it will receive all future contractual cash flows and does not intend to sell and will not be required to sell these investment securities until recovery or maturity. The U.S. Government agency sponsored securities which are listed have call provisions priced at par if called prior to their respective maturity dates.

Other Comprehensive Income (Loss)

The change in other comprehensive income (loss) components and related tax benefit are as follows for the nine months ended September 30, 2011 and September 30, 2010. (In thousands):

	September 30,		
	2011		
	Before-Tax Amount	Tax Benefit	Net-of-Tax Amount
Unrealized gain on securities available for sale:			
Unrealized holding gain arising during the year	\$ 3,951	\$ (1,578)	\$ 2,373
Other comprehensive income	\$ 3,951	\$ (1,578)	\$ 2,373

	September 30,		
	2010		
	Before-Tax Amount	Tax Benefit	Net-of-Tax Amount
Unrealized gain on securities available for sale:			
Unrealized holding gain arising during the year	\$ 169	\$ (68)	\$ 101
Other comprehensive income	\$ 169	\$ (68)	\$ 101

NOTE 7 – LOANS RECEIVABLE

The Company monitors and assesses the credit risk of its loan portfolio using the classes set forth below. These classes also represent the segments by which the company monitors the performance of its loan portfolio and estimates its allowance for loan losses.

Commercial loans include short and long-term business loans and commercial lines of credit for the purposes of providing working capital, supporting accounts receivable, purchasing inventory and acquiring fixed assets. The loans generally are secured by these types of assets as collateral and/or by personal guarantees provided by principals of the borrowers.

Commercial real estate loans are generally originated in amounts up to the lower of 75% of the appraised value or cost of the property and are secured by improved property such as multi-family dwelling units, office buildings, retail stores, ware-houses, church buildings and other non-residential buildings, most of which are located in the Company's market area. Commercial real estate loans are generally made with fixed interest rates which mature or reprice in five to seven years with principal amortization of up to 25 years.

Residential real estate loans consist of loans secured by one- to four-family residences located in the Bank's market area. The Bank has originated one- to four-family residential mortgage loans in amounts up to 80% of the lesser of the appraised value or selling price of the mortgaged property without requiring mortgage insurance. A mortgage loan originated by the Bank, for owner occupied property, whether fixed rate or adjustable rate, can have a term of up to 30 years. Loans secured by non-owner occupied property, whether fixed rate or adjustable rate, can have a term of up to 25 years. Adjustable rate loan terms limit the periodic interest rate adjustment and the minimum and maximum rates that may be charged over the term of the loan based on the type of loan.

Construction loans will be made only if there is a permanent mortgage commitment in place. Interest rates on commercial construction loans are typically in line with normal commercial mortgage loan rates, while interest rates on residential construction loans are slightly higher than normal residential mortgage loan rates. These loans usually are adjustable rate loans and generally have terms of up to one year.

Consumer loans include installment loans and home equity loans, secured by first or second mortgages on homes owned or being purchased by the loan applicant. Home equity term loans and credit lines are credit accommodations secured by either a first or second mortgage on the borrower's residential property. Interest rates charged on home equity term loans are generally fixed; interest on credit lines is usually a floating rate related to the prime rate. The

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Bank generally requires a loan to value ratio of less than or equal to 80% of the appraised value, including any outstanding prior mortgage balance.

Loans receivable consist of the following (in thousands):

	September 30, 2011	December 31, 2010
Commercial	\$ 105,859	\$ 95,441
Real estate, Commercial	110,637	112,217
Real estate, Residential	9,131	14,780
Construction	11,741	13,177
Consumer loans	7,190	7,450
Net deferred loan fees	(272)	(209)
	244,286	242,856
Allowance for loan losses	(2,848)	(3,826)
Loans receivable, net	\$ 241,438	\$ 239,030

Under New Jersey banking laws, the Bank is subject to a loans-to-one-borrower limitation of 15% of capital funds for most loans. At September 30, 2011, the loans-to-one-borrower limitation was approximately \$4.7 million; this excludes an additional 10% of capital funds, or approximately \$3.1 million which may be loaned if collateralized by readily marketable securities. At September 30, 2011, there were no loans outstanding or committed to any one borrower which individually or in the aggregate exceeded the Bank's loans-to-one-borrower limitation of 15% of capital funds.

A summary of the Company's credit quality indicators is as follow:

Pass - A credit which is assigned a rating of Pass shall exhibit some or all of the following characteristics:

- a. Loans that present an acceptable degree of risk associated with the financing being considered as measured against earnings and balance sheet trends, industry averages, etc. Actual and projected indicators and market conditions provide satisfactory evidence that the credit will perform as agreed.
- b. Loans to borrowers that display acceptable financial conditions and operating results. Debt service capacity is demonstrated and future prospects are considered good.
- c. Loans to borrowers where a comfort level is achieved by the strength of the cash flows from the business or project and the strength and quantity of the collateral or security position (i.e.: receivables, inventory and other readily marketable securities) as supported by a current valuation and/or the strong capabilities of a guarantor.

Special Mention - Loans on which the credit risk requires more than ordinary attention by the Loan Officer. This may be the result of some erosion in the borrower's financial condition, the economics of the industry, the capability of management, or changes in the original transaction. Loans which are currently sound yet exhibit potentially unacceptable credit risk or deteriorating long term prospects, will receive this classification. Loans which deviate from loan policy or regulations will not generally be classified in this category, but will be separately reported as an area of concern.

Classified – Classified loans include those considered by the Company to be substandard, doubtful or loss.

An asset is considered "substandard" if it involves more than an acceptable level of risk due to a deteriorating financial condition, unfavorable history of the borrower, inadequate payment capacity, insufficient security or other negative factors within the industry, market or management. Substandard loans have clearly defined weaknesses which can

jeopardize the timely payment of the loan.

Assets classified as “doubtful” exhibit all of the weaknesses defined under the substandard category but with enough risk to present a high probability of some principal loss on the loan, although not yet fully ascertainable in amount.

Assets classified as “loss” are those considered uncollectible or of little value, even though a collection effort may continue after the classification and potential charge-off.

Non-Performing Loans

Non-performing loans consist of non-accrual loans (loans on which the accrual of interest has ceased), loans over ninety days delinquent and still accruing interest, renegotiated loans and impaired loans. Loans are generally placed on non-accrual status if, in the opinion of management, collection is doubtful, or when principal or interest is past due 90 days or more, unless the collateral is considered sufficient to cover principal and interest and the loan is in the process of collection. At September 30, 2011 the Company had twenty one loan relationships totaling \$15.9 million in non-accrual loans compared to twelve relationships totaling \$9.8 million in non-accrual loans at December 31, 2010. The Company recognized no interest income on non-accrual loans during the nine month period ended September 30, 2011 as compared to \$149 thousand for the nine month period ended September 30, 2010.

The following table represents loans by credit quality indicator at September 30, 2011.

(In thousands)		<u>Pass</u>	<u>Special Mention Loans</u>	<u>Classified Loans</u>	<u>Non Performing Loans</u>	<u>Total</u>
Commercial	\$	97,686	\$ -	3,724	\$ 311	\$ 105,721
Real Estate, Commercial		97,594	246	2,352	10,312	110,504
Real Estate, Residential		8,159	-	-	964	9,123
Construction		11,714	-	-	-	11,714
Consumer		6,644	-	243	337	7,224
Total loans	\$	221,797	\$ 246	\$ 6,319	\$ 15,924	\$ 244,286

The following table represents loans by credit quality indicator at December 31, 2010.

(In thousands)		<u>Pass</u>	<u>Special Mention Loans</u>	<u>Classified Loans</u>	<u>Non Performing Loans</u>	<u>Total</u>
Commercial	\$	93,209	\$ 845	\$ -	\$ 1,296	\$ 95,350
Real Estate, Commercial		101,718	2,175	-	8,213	112,106
Real Estate, Residential		13,596	-	1,170	-	14,766
Construction		13,145	-	-	-	13,145
Consumer		6,905	244	51	289	7,489
Total loans	\$	228,572	\$ 3,264	\$ 1,221	\$ 9,798	\$ 242,856

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The following table represents past-due loans as of September 30, 2011.

(In thousands)	30-89 Days Past Due and <u>Still Accruing</u>	90 Days or more Past Due and <u>Still Accruing</u>	Total Past Due and <u>Still Accruing</u>	Accruing Current <u>Balances</u>	Non- Accrual <u>Balances</u>	Total Loan <u>Balances</u>
Commercial	\$ 2,032	\$ -	\$ 2,032	\$ 101,410	\$ 4,311	\$ 105,721
Real Estate, Commercial	-	-	-	100,192	10,312	110,504
Real Estate, Residential	-	-	-	8,159	964	9,123
Construction	-	138	138	11,714	-	11,852
Consumer	1	243	244	6,887	337	7,424
Total loans and leases	\$ 2,033	\$ 381	\$ 2,414	\$ 228,362	\$ 15,924	\$ 244,286
Percentage of total loans	0.84%	0.16%	1.00%	94.60%	6.60%	

The following table represents past-due loans as of December 31, 2010.

(In thousands)	30-89 Days Past Due and <u>Still Accruing</u>	90 Days or more Past Due and <u>Still Accruing</u>	Total Past Due and <u>Still Accruing</u>	Accruing Current <u>Balances</u>	Non- Accrual <u>Balances</u>	Total Loan <u>Balances</u>
Commercial	\$ 209	\$ 634	\$ 843	\$ 94,054	\$ 1,296	\$ 95,347
Real Estate, Commercial	-	-	-	103,893	8,213	112,106
Real Estate, Residential	-	244	244	14,766	-	15,010
Construction	-	-	-	13,145	-	13,145
Consumer	-	-	-	7,200	289	7,489
Total loans	\$ 209	\$ 878	\$ 1,087	\$ 233,058	\$ 9,798	\$ 242,855
Percentage of total loans	0.09%	0.36%	0.45%	95.97%	4.03%	

Impaired loans are measured based on the present value of expected future discounted cash flows, the fair value of the loan or the fair value of the underlying collateral if the loan is collateral dependent. The recognition of interest income on impaired loans is the same as for non-accrual loans discussed above. At September 30, 2011, the Company had thirty impaired loan relationships totaling \$17.5 million (included within the non-accrual loans discussed above) in which \$8.7 million in impaired loans had a related allowance for credit losses of \$1.2 million and \$8.8 million in impaired loans in which there is no related allowance for credit losses. The average balance of impaired loans totaled \$17.9 million as of September 30, 2011, and interest income recorded on impaired loans during the nine months ended September 30, 2011 totaled \$9 thousand, as compared to \$149 thousand for the nine months ended September 30, 2010.

At September 30, 2011 the Company had two loan relationships totaling \$381 thousand that were delinquent ninety days or more and still accruing interest. At December 31, 2010, the Company had two loan relationships totaling \$878 thousand that were delinquent ninety days or more and still accruing interest.

The following table represents data on impaired loans at September 30, 2011 and September 30, 2010.

(In thousands)	2011	2010
Impaired loans for which a valuation allowance has been provided	\$ 8,652	\$ 3,696
Impaired loans for which no valuation allowance has been provided	8,802	8,004
Total loans determined to be impaired	17,454	11,700
Allowance for loan losses related to impaired loans	1,229	1,848
Average recorded investment in impaired loans	17,919	12,717
Cash basis interest income recognized on impaired loans	\$ 9	\$ 149

The following table presents impaired loans by portfolio class at September 30, 2011.

(In thousands)	Recorded <u>Investment</u>	Unpaid Principal <u>Balance</u>	Related Valuation <u>Allowance</u>	Average Annual Recorded <u>Investment</u>	Interest Income Recognized While <u>Impaired</u>
Impaired loans with a valuation allowance:					
Commercial	\$ 1,669	\$ 1,669	\$ 151	\$ 1,725	\$ -
Real Estate, Commercial	5,824	5,824	911	6,091	-

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Real Estate, Residential	964	964	69	1,105	-
Consumer	195	195	98	196	-
Subtotal	8,652	8,652	1,229	9,117	-
Impaired loans with no valuation allowance:					
Commercial	3,791	3,791	-	3,791	-
Real Estate, Commercial	4,626	4,626	-	4,626	3
Real Estate, Residential	-	-	-	-	-
Consumer	385	385	-	385	6
Subtotal	8,802	8,802	-	8,802	9
Total Impaired loans:					
Commercial	5,460	5,460	151	5,516	-
Real Estate, Commercial	10,450	10,450	911	10,717	3
Real Estate, Residential	964	964	69	1,105	-
Consumer	580	580	98	581	6
Total	\$ 17,454	\$ 17,454	\$ 1,229	\$ 17,919	\$ 9

The following table presents impaired loans by portfolio class at December 31, 2010.

(In thousands)

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Valuation Allowance</u>	<u>Average Annual Recorded Investment</u>	<u>Interest Income Recognized While Impaired</u>
Impaired loans with a valuation allowance:					
Commercial	\$ 1,198	\$ 1,198	\$ 962	\$ 1,209	
Real Estate, Commercial	2,060	2,060	1,020	2,064	
Consumer	199	199	99	200	
Subtotal	3,457	3,457	2,081	3,473	
Impaired loans with no valuation allowance:					
Commercial	732	732	-	1,341	
Real Estate, Commercial	6,153	6,153	-	7,085	
Consumer	385	385	-	381	
Subtotal	7,271	7,271	-	8,807	
Total Impaired loans:					
Commercial	1,930	1,930	962	2,550	
Real Estate, Commercial	8,213	8,213	1,020	9,149	
Consumer	584	584	99	581	
Total	\$ 10,728	\$ 10,728	\$ 2,081	\$ 12,280	

Included in the balance of non accrual commercial loans is a principal balance of \$634 thousand dollars representing the Company's participation interest in two loans originated by another New Jersey based institution. Although the borrowers have ceased making payments on these loans, we have received a legal opinion from our legal counsel that the Company has valid claims against the lead/originating bank for violations of the participation agreements, and we have filed suit asserting these claims. In the event the lead bank is unable to collect from the borrowers, we believe, based on said legal opinion, that we may collect our principal and interest from the lead/originating bank. However, in that case our ability to collect on these loans will depend upon the outcome of our legal action against the lead/originating bank.

The following table provides information regarding risk elements in the loan portfolio as of September 30, 2011 and December 31, 2010

(In thousands)

Non-performing assets:

September 30, 2011

December 31, 2010

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Loans past due 90 days or more and accruing			
Commercial	\$	-\$	634
Construction		138	-
Consumer		243	244
Total loans past due 90 days or more and accruing		381	878
Non-accrual loans:			
Commercial		4,311	1,296
Real Estate, Commercial		10,312	8,213
Real Estate, Residential		964	-
Consumer		337	289
Total non-accrual loans		15,924	9,798
Impaired loans		455	51
Restructured loans		694	-
Total non-performing loans		17,073	9,849
Real estate owned		830	830
Total non-performing assets	\$	18,284	\$ 11,557
Non-performing loans as a percentage of loans		6.99%	4.06%
Non-performing assets as a percentage of loans and real estate owned		7.46%	4.76%
Non-performing assets as a percentage of total assets		4.68%	3.26%

During the nine month period ended September 30, 2011 the Company experienced a \$6.1 million increase in non-accrual loans. This change reflects the downgrading of eleven credit relationships to non-accrual status totaling \$8.8 million partially offset by partial and total charge offs of nine credit relationships representing twenty one loans in the amount of \$2.4 million and principal reductions on non accrual loans of \$334 thousand during the nine month period ended September 30, 2011. The downgraded loans consisted of two residential mortgage loans totaling \$964 thousand, six commercial relationships representing eleven loans totaling \$4.3 million, three commercial real estate loans totaling \$2.6 million and one consumer loan totaling \$48 thousand.

The following tables set forth activity within the Bank's allowance for losses by portfolio class during the three and nine month periods ended September 30, 2011 and September 30, 2010:

Three months ended September 30, 2011 and September 30, 2010:

<u>Allowance for Loan Losses</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Total</u>
Beginning Balance, July 1, 2011	\$ 833	\$ 1,366	\$ 337	\$ 129	\$ 2,665
Charge-off	(50)	-	-	-	(50)
Provision	146	75	(28)	14	207
Recovery	26	-	-	-	26
Ending Balance, September 30, 2011	\$ 955	\$ 1,441	\$ 309	\$ 143	\$ 2,848

<u>Allowance for Loan Losses</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Total</u>
Beginning Balance, July 1, 2010	\$ 1,789	\$ 1,146	\$ 416	\$ 78	\$ 3,429
Charge-off	-	-	-	-	-
Recovery	1	-	-	-	1
Provision	56	228	(30)	(19)	235
Ending Balance, September 30, 2010	\$ 1,846	\$ 1,374	\$ 386	\$ 59	\$ 3,665

Nine months ended September 30, 2011 and September 30, 2010:

<u>Allowance for Loan Losses</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Total</u>
Beginning Balance, December 31, 2010	\$ 1,743	\$ 1,527	\$ 417	\$ 139	\$ 3,826

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Charge-off	(2,101)	-	(281)	-	(2,382)
Provision	1,287	(86)	173	4	1,378
Recovery	26	-	-	-	26
Ending Balance, September 30, 2011	\$ 955	\$ 1,441	\$ 309	\$ 143	\$ 2,848

<u>Allowance for Loan Losses</u>	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Total</u>
Beginning Balance, January 1, 2010	\$ 1,838	\$ 1,051	\$ 447	\$ 96	\$ 3,432
Charge-off	(149)	-	-	-	(149)
Provision	157	323	(61)	(37)	382
Ending Balance, September 30, 2010	\$ 1,846	\$ 1,374	\$ 386	\$ 59	\$ 3,665

<u>2011</u>	<u>September 30, 2010</u>	<u>September 30,</u>	
Period-end loans outstanding		\$ 244,286	\$ 242,125
Average loans outstanding		\$ 239,844	\$ 237,288
Allowance as a percentage of period-end loans		1.17%	1.51%
Net charge-offs as a percentage of average loans		0.98%	0.06%

<u>Allowance for Loan Losses</u>	Commercial		Residential		<u>Total</u>
	<u>Commercial</u>	<u>Real Estate</u>	<u>Real Estate</u>	<u>Consumer</u>	
Ending balance individually evaluated for impairment	\$ 151	\$ 912	\$ 69	\$ 97	\$ 1,229
Ending balance collectively evaluated for impairment	804	529	240	46	1,619
Ending Balance, September 30, 2011	\$ 955	\$ 1,441	\$ 309	\$ 143	\$ 2,848

<u>Financing receivable:</u>	Commercial		Residential		<u>Consumer</u>	<u>Construction</u>	<u>Total</u>
	<u>Commercial</u>	<u>Real Estate</u>	<u>Real Estate</u>	<u>Real Estate</u>			
Ending balance	\$ 105,721	\$ 110,504	\$ 9,123	\$ 7,224	\$ 11,714	\$ 244,286	\$
Ending balance individually evaluated for impairment	8,035	12,663	964	580	-	22,242	
Ending balance collectively evaluated for impairment	97,686	97,841	8,159	6,644	11,714	222,044	

The Company prepares an allowance for loan loss model on a quarterly basis to determine the adequacy of the allowance. Management considers a variety of factors when establishing the allowance, such as the impact of current economic conditions, diversification of the loan portfolio, delinquency statistics, results of independent loan review and related classifications. Historic loss rates and the loss rates of peer financial institutions are also considered. In evaluating the Company's allowance for loan loss the Company maintains a Criticized Asset Committee ("CAC") consisting of senior management that monitors problem loans and formulates collection efforts and resolution plans for each borrower. On a monthly basis the CAC meets to review each problem loan and determines if there has been any change in collateral

value due to changes in market conditions. Each quarter, when calculating the allowance for loan loss, the CAC reviews an updated loan impairment analysis on each problem loan to determine if a specific provision for loan loss is warranted. Management reviews the most recent appraisal on each loan adjusted for holding and selling costs. In the event there is no recent appraisal on file, the Company will use the aged appraisal and apply a discount factor to the appraisal then deduct the holding and selling costs from the discounted appraisal value. At September 30, 2011, the Company maintained an allowance for loan loss ratio of 1.17% to period end loans outstanding. On a linked basis, our non-performing assets have increased by \$6.7 million over their levels at December 31, 2010 representing a non-performing asset to total asset ratio of 4.68% at September 30, 2011 as compared to a non-performing asset to total asset ratio 3.26% at December 31, 2010.

The Company's charge-off policy states any asset classified loss shall be charged-off within thirty days of such classification unless the asset has already been eliminated from the books by collection or other appropriate entry. On a quarterly basis the Board Loan Committee ("BLC") reviews past due, classified, non-performing and other loans, as it deems appropriate, to determine the collectability of such loans. If the BLC determines a loan to be uncollectible, the loan is charged to the allowance for loan loss. In addition, upon reviewing the collectability of a loan, the BLC may determine a portion of the loan to be uncollectible; in which case that portion of the loan deemed uncollectable will be partially charged-off against the allowance for loan loss.

For the nine month period ending September 30, 2011 the Company experienced fifteen total charge offs relating to seven loan relationships totaling \$1.5 million and seven partial charge-offs relating to five loan relationships totaling \$872 thousand as compared to charge-offs of four loans representing one relationship totaling \$382 thousand for the period ended December 31, 2010.

The Company prepares an allowance for loan loss model on a quarterly basis to determine the adequacy of the allowance



The Company modifies loans by offering a restructuring in loan terms that may include but is not limited to, principal moratoriums and interest rate reductions. Of the 7 loan modifications classified as troubled debt restructures in 2011, 6 involved principal moratoriums and 1 involved a payment restructure which was a concession from the original loan terms.

The following tables present loans by class which were modified as trouble debt restructurings during the three and nine month periods ended September 30, 2011, respectively (in thousands);

Three Months ended September 30, 2011:

Number of Pre Modification Outstanding Recorded Post- Modification Outstanding Recorded

<u>Trouble Debt Restructuring</u>	<u>loans</u>	<u>Investment</u>	<u>Investment</u>
Commercial	4	\$ 374	\$ 374
Commercial Real Estate	1	219	219
Total	5	\$ 593	\$ 593

Nine Months ended September 30, 2011:

Number of Pre Modification Outstanding Recorded Post- Modification Outstanding Recorded

<u>Trouble Debt Restructuring</u>	<u>loans</u>	<u>Investment</u>	<u>Investment</u>
Commercial	6	\$ 475	\$ 475
Commercial Real Estate	1	219	219
Total	7	\$ 694	\$ 694

<u>Trouble Debt Restructuring That Subsequently Defaulted</u>	<u>Number of loans</u>	<u>Recorded Investment</u>
Commercial	2	\$ 101
Total	2	\$ 101

There were no troubled debt restructurings during the three or nine month periods ended September 30, 2010.

NOTE 8 – Bank Owned Life Insurance

Bank owned life insurance (“BOLI”) is carried at its aggregate cash surrender value less surrender charges and totaled \$4.8 million at September 30, 2011. Income of \$121 thousand was recognized on BOLI during the nine month period ended September 30, 2011 as compared to \$123 thousand for the nine month period ended September 30, 2010. The Bank is the sole owner and beneficiary of the BOLI.

NOTE 9 – Deferred Compensation Plans

Effective January 1, 2006, the Bank adopted a Nonqualified Deferred Compensation Plan (The “Executive Plan”) and the Directors’ Fee Deferral and Death Benefit Plan (the “Directors’ Plan”). Both plans provide for payments of deferred compensation to participants. The Company recorded \$238 thousand in deferred compensation expense during the nine month period ended September 30, 2011 as compared to \$128 thousand for the nine month period ended September 30, 2010.

NOTE 10 – Income Taxes

The Company accounts for uncertainties in income taxes in accordance with ASC 740, *Accounting for Uncertainty in Income Taxes*. ASC 740 prescribes a threshold and measurement process for recognizing in the financial statements a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on

derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has determined that there are no significant uncertain tax positions requiring recognition in its financial statements.

Federal tax years 2008 through 2010 remain subject to examination as of September 30, 2011, while tax years 2007 through 2010 remain subject to examination by state taxing jurisdictions. In the event the Company is assessed for interest and/or penalties by taxing authorities, such assessed amounts will be classified in the financial statements as income tax expense.

The ability to realize deferred tax assets is dependent upon a variety of factors, including the generation of future taxable income, the existence of taxes paid and recoverable, the reversal of deferred tax liabilities, and tax planning strategies. Based upon these and other factors, the Company determined that it is more likely than not that our deferred tax asset will be realized. As such, no valuation allowance was established for the deferred tax asset as of September 30, 2011 or December 31, 2010. The Company will continue to reassess the realizability of the deferred tax asset in future periods. If, in the future, it is determined that the Company's deferred tax asset is not realizable, a valuation allowance may be established against the deferred tax asset, which may have a material impact on the Company's net income in the period in which it is recorded.

NOTE 11 – Fair Value of Financial Instruments

ASC 820 *Fair Value Measurements and Disclosures* establishes a framework for measuring fair value under U.S. generally accepted accounting principles, and expands disclosure requirements for fair value measurements.

ASC 820 does not require any new fair value measurements.

ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels, as described below:

- Level 1. Level 1 inputs are unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable, either directly or indirectly. Level 2 inputs include quoted prices for similar assets, quoted prices in markets that are not considered to be active, and observable inputs other than quoted prices such as interest rates.
- Level 3. Level 3 inputs are unobservable inputs.

The fair value of securities available for sale are determined by obtaining quoted prices on a nationally recognized securities exchange (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

A financial instrument's level within the fair value hierarchy is based upon the lowest level of any input significant to the fair value measurement.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements at September 30, 2011			Fair Value Measurements at December 31, 2010	
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs Level (2)	Significant other Unobservable Inputs Level (3)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs Level (2)
Assets :					
Investment Securities					
US Government Obligations	\$ -	\$ 62,081	\$ -	\$ -	\$ 35,560
US Treasury Securities	\$ -	\$ -	\$ -	\$ 9,075	\$ -
Total assets on a recurring basis at fair value	\$ -	\$ 62,081	\$ -	\$ 9,075	\$ 35,560

Assets and Liabilities Measured on a Non-Recurring Basis

Assets and liabilities measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at September 30, 2011			Fair Value Measurements at September 30, 2010		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs Level (2)	Significant other Unobservable Inputs Level (3)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant other Observable Inputs Level (2)	Significant other Unobservable Inputs Level (3)
Assets :						
Impaired loans	\$ -	\$ 17,454	\$ -	\$ -	\$ 10,727	\$ -
Other real estate owned	\$ -	\$ 830	\$ -	\$ -	\$ 830	\$ -
Total assets on a non recurring basis at fair value	\$ -	\$ 18,284	\$ -	\$ -	\$ 11,557	\$ -

The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals.

These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach.

The following required disclosure of the estimated fair value of financial instruments has been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

As required by ASC 825-10-65, the estimated fair value of financial instruments at September 30, 2011 and December 31, 2010 was as follows:

(In thousands)	September 30, 2011		December 31, 2010	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets:				
Cash and cash equivalents	\$ 46,697	\$ 46,697	\$ 9,031	\$ 9,031
Investments held to maturity				
Federal Agency Securities	14,982	15,135	32,706	31,643
Mortgage-backed Securities	6,947	7,434	7,729	7,877
Investments available for sale				
US Treasury Securities	-	-	9,075	9,075
Federal Agency Securities	62,081	62,081	35,560	35,560
Loans receivable	244,286	274,217	242,856	265,397
FHLB stock	1,438	1,438	1,435	1,435
Bank owned life insurance	4,806	4,806	4,685	4,685
Accrued interest receivable	1,815	1,815	2,152	2,152

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Total financial assets	\$ 383,052	\$ 413,623	\$ 345,229	\$ 366,855
Financial Liabilities:				
Checking accounts	\$ 53,193	\$ 53,193	\$ 59,625	\$ 59,625
Statement savings accounts	3,530	3,530	3,203	3,203
Money market accounts	9,883	9,883	10,248	10,248
Index accounts	152,631	152,631	115,697	115,697
Certificates of deposit	110,506	108,662	113,497	112,495
FHLB advances	25,000	25,000	25,000	25,000
Line of credit	5,000	5,000	4,877	4,877
Subordinated debt	3,000	3,000	3,000	3,000
Accrued interest payable	173	173	187	187
Total financial liabilities	\$ 362,916	\$ 361,072	\$ 335,334	\$ 334,332
	Contract	Estimated	Contract	Estimated
	Value	Fair Value	Value	Fair Value
Off-balance sheet instruments:				
Commitments to extend credit	\$ 46,760	\$ -	\$ 58,051	\$ -

The forgoing fair values are presented pursuant to the requirements of GAAP and ASC topic 825-10-65 for disclosure purposes only, and should

not be considered to represent the value of the Company as a whole.

NOTE 12 – Recent Accounting Pronouncements

Below is a discussion of recent accounting pronouncements. Recent pronouncements not discussed below were deemed to not be applicable to the Company.

In January 2011, the FASB issued ASU No. 2011-01 *Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20*. This Update temporarily delayed the effective date of the disclosures about troubled debt restructurings in Update 2010-20 for public entities. The amendments in this Update delayed the effective date of the new disclosures about troubled debt restructurings for public entities and the coordination of the guidance for determining what constitutes a troubled debt restructuring until interim and annual periods beginning after June 15, 2011. The Company adopted ASU 2011-01 during the third quarter 2011 and the relevant disclosures are included in this Form 10-Q.

In April 2011, The FAS issued ASU 2011-02, *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*, which amended guidance for evaluating whether the restructuring of a receivable by a creditor is a troubled debt restructuring (TDR). The ASU responded to concerns that creditors are inconsistently applying existing guidance for identifying TDRs. It is effective for interim and annual periods beginning on or after June 15, 2011. The adoption of ASU 2011-02 did not have a material impact to the financial statements.

In May 2011, the FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, to provide largely identical guidance about fair value measurement and disclosure requirements with the IASB's new IFRS 13, *Fair Value Measurement*. Issuing this standard completed a major project of the Boards' joint work to improve and converge IFRS and U.S. GAAP. The new standard does not extend the use of fair value but, rather, provides guidance about how fair value should be applied where it already is required or permitted under U.S. GAAP. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011. The Company does not expect the adoption of ASU 2011-04 to have a material impact to the financial statements.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income*. This ASU increases the prominence of other comprehensive income in financial statements. Under this ASU, an entity will have the option to present the components of net income and comprehensive income in either one or two consecutive financial statements. The ASU eliminates the option in U.S. GAAP to present other comprehensive income in the statement of changes in equity. ASU 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The adoption of ASU 2011-05 will impact the Company's presentation of comprehensive income within the financial statements. However, it will not impact the financial statements amounts.

NOTE 13– Private Placement Common Stock Offering and Preferred Stock Issuance

In June 2009, the Board of Directors of the Company approved a private placement common stock offering to accredited investors. In connection with this offering, the Board of Directors approved the issuance of common stock purchase warrants. As part of the offering, one warrant was issued for each share of Company common stock, no par value, sold in the stock offering. Each warrant issued under the offering will allow the holder of the warrant to purchase one share of Company common stock, for a price of \$9.00 per share through June 26, 2013. For the year ended December 31, 2009, the Company sold 153,889 shares under this offering and issued 153,889 common stock warrants. The \$1.1 million proceeds received from the common stock offering were recorded as additional paid in capital.

In December 2009, the Company authorized the establishment of 2,000 shares of no par, \$1,000 stated value, Series A Perpetual Non-Cumulative Preferred Stock. The preferred stock is entitled to receive, as and when declared by the Company's Board of Directors, non-cumulative cash dividends at an annual rate of 7% of the stated value. In December 2009, the Company sold 1,900 preferred shares. The preferred stock is redeemable at the Company's option at any time after six months from the issue date at the stated value plus any dividends declared but unpaid. The preferred shares have priority of dividends such that no dividends or distributions shall be declared or paid to common shareholders unless full dividends on all outstanding preferred shares have been declared and paid for the most recently completed calendar quarter.

NOTE 14 – Subsequent Events

The Company has evaluated subsequent events through the filing date of this report, and determined that there were no recognized or unrecognized subsequent events to report.

Item 2. Management's Discussion and Analysis

Forward-Looking Statements

Cornerstone Financial Corporation (the "Company") may from time to time make written or oral "forward-looking statements," including statements contained in the Company's filings with the Securities and Exchange Commission (including this Quarterly Report on Form 10-Q/A and the exhibits hereto), in its reports to shareholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements involve risks and uncertainties, such as statements of the Company's plans, objectives, expectations, estimates and intentions that are subject to change based on various important factors (many of which are beyond the Company's control). Forward-looking statements may be identified by the use of words such as "expects," "subject," "believe," "will," "intends," "will be," or "would." The factors which could cause the Company's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements include those items listed under "Item 1A-Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010 and the following factors, among others: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System ("Federal Reserve"); inflation; interest rates; market and monetary fluctuations; the timely development of new products and services by the Company and the perceived overall value of these products and services by users, including the features, pricing and quality compared to competitors' products and services; the success of the Company in gaining regulatory approval of its products, services, dividends and of new branches, when required; the impact of changes in financial services laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; acquisitions; the ability to continue to effectively manage costs, including the costs incurred in connection with the opening of new branches; changes in consumer spending and saving habits; the Company's ability to access the capital markets to maintain its regulatory capital standing and the success of the Company at managing the risks resulting from these factors.

The Company cautions that the above listed factors are not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

Overview

Cornerstone Financial Corporation

The Company was formed in 2008 at the direction of the Board of Directors of Cornerstone Bank (the “Bank”) to serve as a holding company for the Bank. The Board believed that establishing a holding company would provide greater flexibility in raising capital and conducting the Bank’s business. The holding company reorganization was completed in January 2009.

At September 30, 2011, we had total assets of \$390.4 million, total loans, gross of \$244.3 million, total investment securities of \$84.0 million and total deposits of \$329.7 million compared to total assets of \$354.0 million, total

loans, gross of \$242.8 million, total investment securities of \$85.1 million and total deposits of \$302.3 million at December 31, 2010. Our growth in assets and deposits reflects our commitment to provide outstanding customer service and a broad array of banking products driven by our customers' needs. We believe our strategy provides us with a competitive advantage over other financial institutions by developing lasting customer relationships that will enable us to continue to attract core deposits and loans within our market area.

Interest Rate Risk

Our primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on our net interest income while creating an asset/liability structure that maximizes earnings. Our Asset Liability Management Committee actively monitors and manages our interest rate exposure using gap analysis and interest rate simulation models.

Gap analysis measures the difference between volumes of rate-sensitive assets and liabilities and quantifies these repricing differences for various time intervals. Static gap analysis describes interest rate sensitivity at a point in time. However, gap analysis alone does not accurately measure the potential magnitude of changes in net interest income since changes in interest rates do not affect assets and liabilities at the same rate, to the same extent, or on the same basis. Furthermore, static gap analysis does not consider future growth or changes in the asset mix.

A positive gap (asset sensitive) indicates that more assets reprice during a given period compared to liabilities, while a negative gap (liability sensitive) indicates that more liabilities reprice during a given period compared to assets.

Generally, during a period of falling interest rates, a positive gap would tend to adversely affect net interest income, while a negative gap would tend to result in an increase in net interest income. During a period of rising interest rates, in general, a positive gap would tend to result in an increase in net interest income while a negative gap would tend to affect net interest income adversely. However, certain assets and liabilities may react differently to changes in interest rates even though they reprice or mature in the same or similar time periods. The interest rates on certain assets and liabilities may change at different times than changes in market interest rates, with some changing in advance of changes in market rates and some lagging behind changes in market rates. Also, certain assets (e.g., adjustable rate mortgages) often have provisions that may limit changes both each time the interest rate changes and on a cumulative

basis over the life of the loan. Additionally, the actual prepayments and withdrawals in the event of a change in interest rates may differ significantly from those assumed in the calculations shown in the table below. Finally, the ability of borrowers to service their debt may decrease in the event of an interest rate increase. Consequently, any model used to analyze interest rate sensitivity will be vulnerable to the assumptions made with respect to the foregoing factors.

We use a computer-based simulation model to assess the impact of changes in interest rates on net interest income. The model incorporates management's business plan assumptions and related asset and liability yields/costs, deposit sensitivity and the size, composition and maturity or repricing characteristics of our assets and liabilities. The assumptions are based on what management believes at that time to be the most likely interest rate environment. Actual results may differ from simulated results due to the various factors discussed above.

The following table sets forth the amount of our interest-earning assets and interest-bearing liabilities at September 30, 2011, which are expected to mature or reprice in each of the time periods shown:

	One-Five		Non-Rate	
	One Year	Years	Over	Sensitive
(In thousands)	or Less		Five Years	Assets/
				Liabilities
				Total
<u>Interest-earning assets:</u>				
Short term investments	\$ 40,400	\$ -	\$ -	\$ 40,400
Investment securities held to maturity	-	-	21,929	-
Investment securities available for sale			62,081	=
Loans receivable	<u>126,910</u>	<u>67,576</u>	<u>49,800</u>	=
Total interest-earning assets	<u>167,310</u>	<u>67,576</u>	<u>133,810</u>	=
<i>Non-rate sensitive assets:</i>				
Other assets	=	=	=	<u>21,727</u>
Total assets	\$ <u>167,310</u>	\$ <u>67,576</u>	\$ <u>133,810</u>	\$ <u>21,727</u>
<u>Interest-bearing liabilities:</u>				
Interest-bearing demand	\$ 24,542	\$ -	\$ -	\$ 24,542
Statement savings	3,530	-	-	3,530
Money market	162,514	-	-	162,514
Certificates of deposit	59,640	50,866	-	110,506
Subordinated debt	-	3,000	-	3,000
Borrowings	<u>20,000</u>	<u>10,000</u>	=	<u>30,000</u>

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Total interest-bearing liabilities	<u>270,226</u>	<u>63,866</u>	=	=	<u>334,092</u>
<i>Non-rate sensitive liabilities:</i>					
Non-interest bearing deposits	-	-	-	28,651	28,651
Other liabilities	-	-	-	6,638	6,638
Capital	=	=	=	<u>21,042</u>	<u>21,042</u>
Total liabilities and capital	\$				