Kent & Essex Mutual Insurance Company

Financial Statements

For the year ended December 31, 2008

BDO Dunwoody LLP
Chartered Accountants
and Advisors

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Auditors' Report

To the Policyholders of
Kent & Essex Mutual Insurance Company

We have audited the balance sheet of Kent & Essex Mutual Insurance Company as at December 31, 2008 and the statements of operations, policyholders' equity, comprehensive income and cash flows for the year then ended. 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2008 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

BDO DUNWOODY LLP

Chartered Accountants, Licensed Public Accountants
Chatham, Ontario
January 16, 2009

Kent & Essex Mutual Insurance Company
Balance Sheet

December 31	2008	2007
Assets		
Current		
Cash (Note 2)	**$ 1,853,650**	$ 1,992,835
Accrued interest receivable	**230,270**	286,459
Investments (Note 3)	**37,830,957**	40,589,071
Receivable from brokers and policyholders	**3,218,869**	2,989,576
Due from reinsurers	**8,445,727**	6,370,722
Income taxes recoverable	**948,045**	360,280
	52,527,518	52,588,943
Other Assets		
Deferred policy acquisition costs	**1,169,381**	1,120,692
Capital assets (Note 4)	**3,829,025**	1,831,165
Future income tax asset	**146,000**	76,000
Share of Facility Association assets	**-**	1,962
	5,144,406	3,029,819
	$ 57,671,924	$ 55,618,762
Liabilities and Policyholders' Equity		
Liabilities		
Provision for unpaid claims (Note 5)	**$ 20,716,131**	$ 15,044,304
Provision for unearned premiums	**7,242,401**	6,933,457
Due to reinsurers	**101,164**	62,612
Due to Facility Association	**16,085**	-
Provision for premium refund	**-**	722,000
Accounts payable	**283,670**	327,064
	28,359,451	23,089,437
Policyholders' Equity		
Policyholder's surplus	**29,185,901**	30,099,876
Accumulated other comprehensive income	**126,572**	2,429,449
	29,312,473	32,529,325
	$ 57,671,924	$ 55,618,762

On behalf of the Board:

_______________________ Director

_______________________ Director

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

Kent & Essex Mutual Insurance Company
Statement of Operations

For the year ended December 31	2008	2007
Gross premiums written	**$ 15,145,701**	$ 14,504,225
Reinsurance premiums (Note 6)	**2,558,156**	2,301,293
Net premiums written	**12,587,545**	12,202,932
Increase in provision for unearned premiums	**308,944**	84,666
Net premiums earned	**12,278,601**	12,118,266
Underwriting expenses		
Claims incurred	**9,567,987**	7,863,963
Adjusting	**259,598**	223,140
Commissions	**2,403,652**	2,420,232
Salaries and fees	**1,040,280**	1,021,183
Fire prevention and inspections	**27,776**	39,300
Other	**896,586**	637,163
	14,195,879	12,204,981
Underwriting loss before premium refund	**(1,917,278)**	(86,715)
Premium refund to policyholders	**-**	722,000
Underwriting loss	**(1,917,278)**	(808,715)
Other income/expenses		
Investment income	**844,651**	2,295,169
Loss on disposition of capital assets	**(86,348)**	-
Refund of Surplus - FMRP Inc.	**-**	195,579
Asset impairment charges (Note 3)	**-**	(71,387)
	758,303	2,419,361
Income (loss) before income tax	**(1,158,975)**	1,610,646
Income tax		
Current income tax	**(235,000)**	172,877
Future income tax	**(10,000)**	42,000
	(245,000)	214,877
Net income (loss) for the year	**$ (913,975)**	$ 1,395,769

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

Kent & Essex Mutual Insurance Company
Statement of Policyholders' Equity

For the year ended December 31	2008	2007
Policyholders' surplus,		
Balance, beginning of the year	**$ 30,099,876**	$ 28,704,107
Net income (loss) for the year	**(913,975)**	1,395,769
Balance, end of the year	**29,185,901**	30,099,876
Accumulated other comprehensive income (loss)		
Balance, beginning of the year	**2,429,449**	-
Transition adjustment on adoption of financial instrument standards (Note 1)	**-**	3,197,191
Other comprehensive loss for the year	**(2,302,877)**	(767,742)
Balance, end of the year	**126,572**	2,429,449
Policyholders' equity, end of the year	**$ 29,312,473**	$ 32,529,325

Kent & Essex Mutual Insurance Company
Statement of Comprehensive Income

For the year ended December 31	2008	2007
Net income (loss) for the year	**$ (913,975)**	$ 1,395,769
Other comprehensive income (loss)		
Unrealized loss on available for sale securities	**(3,239,969)**	(1,541,934)
Reclassification to income of realized gain on available for sale securities	**288,092**	554,192
Related income tax effect	**649,000**	220,000
Other comprehensive loss for the year	**(2,302,877)**	(767,742)
Comprehensive income (loss) for the year	**$ (3,216,852)**	$ 628,027

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

Kent & Essex Mutual Insurance Company
Statement of Cash Flows

For the year ended December 31	2008	2007
Cash flows from operating activities		
Net income (loss) for the year	**$ (913,975)**	$ 1,395,769
Adjustments for		
Amortization of capital assets	**144,500**	83,500
Amortization of bond premium	**119,866**	108,915
Future income tax	**(10,000)**	42,000
Loss on disposal of capital assets	**86,348**	17,094
	(573,261)	1,647,278
Change in non-cash working capital items		
Provision for unpaid claims	**5,671,827**	3,578,495
Provision for unearned premiums	**308,944**	84,665
Provision for premium refund	**(722,000)**	15,000
Receivable from brokers and policyholders	**(229,293)**	(208,660)
Accrued interest receivable	**56,189**	(42,314)
Due from reinsurers	**(2,036,453)**	(3,258,105)
Deferred policy acquisition costs	**(48,689)**	(12,062)
Accounts payable	**(43,395)**	14,535
Income taxes payable (recoverable)	**(587,765)**	(242,806)
Share of Facility Association assets	**18,047**	10,808
	1,814,151	1,586,834
Cash flows from investing activities		
Net increase in investments	**275,371**	374,448
Purchase of capital assets	**(2,676,280)**	(1,046,905)
Proceeds on disposal of capital assets	**447,573**	4,700
	(1,953,336)	(667,757)
Increase (decrease) in cash during the year	**(139,185)**	919,077
Cash, beginning of year	**1,992,835**	1,073,758
Cash, end of year	**$ 1,853,650**	$ 1,992,835

Additional information

Income taxes paid (recovered)	**$ (212,336)**	$ 415,683

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

Nature of Business

Kent & Essex Mutual Insurance Company is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property and casualty insurance in Ontario.

The accounting policies of the company conform with those generally accepted in Canada and comply with the requirements for filing with the Financial Services Commission of Ontario (the "regulators").

Revenue Recognition

Insurance premiums earned are included in income on a daily pro rata basis over the life of the policies. Investment income is recognized as revenue when earned on the accrual basis. Gains and losses on disposal of investments are determined on a completed transaction basis.

Deferred Policy Acquisition Costs

Acquisition costs related to unearned premiums, which comprise primarily commissions are deferred and amortized to income over the periods in which the premiums are earned. The method followed in determining the deferred acquisition costs limits the amount of the deferral to its realizable value by giving consideration to claims and expenses expected to be incurred as the premiums are earned.

Provisions for Unpaid Claims

Unpaid claims and related adjusting expenses are determined using cash-basis evaluations plus an amount for adverse development and are estimates of the ultimate cost of all insurance claims incurred to December 31, 2008.

The provision for unpaid claims represents the amounts needed to provide for the estimated cost of settling claims related to insured events (both reported and unreported) that have occurred on or before each balance sheet date. All provisions are periodically evaluated in light of emerging claim experience and changing circumstances. The resulting changes in estimates of the ultimate claim liability are reflected in current operations.

Reinsurance

Reinsurance premiums and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts. Estimates of amounts recoverable from the reinsurer on unpaid claims and adjusting expenses are recorded as due from reinsurers. A contingent liability exists with respect to reinsurance which could become a liability of the company in the event that the reinsurer might be unable to meet its obligations under the reinsurance agreements.

Capital Assets

Capital assets are recorded at cost. Amortization is provided at the following annual rates:

	Method	Rate
Building	straight line	2%
Parking lot	straight line	5%
Computer equipment	straight line	33%
Office furniture	straight line	7%
Office equipment	straight line	20%
Signs	straight line	4%

The amortization method was changed during the year from declining balance to straight line method (See note 1).

Income Taxes

The asset and liability method of tax allocation is used in accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities, and measured using substantively enacted tax rates and laws that will be in effect when the differences are expected to be reversed.

The company is responsible for income taxes on the portion of its income that relates to non-farm business.

Use of Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from management's best estimates as additional information becomes available in the future.

Financial Instruments

The company recognizes and measures financial assets and financial liabilities on the balance sheet when they become a party to the contractual provisions of a financial instrument. All transactions related to financial instruments are recorded on a settlement date basis. All financial instruments are measured at fair value on initial recognition. Measurement in subsequent periods depends on whether the financial instrument has been classified as held for trading, loans and receivables, available for sale or other financial liabilities.

Held for Trading

Financial assets classified as held for trading are measured at fair value. The financial instrument included in this category is cash.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable repayment dates, usually with interest, that are not debt securities or instruments classified as held for trading on initial recognition. Accounts receivable have been classified as loans and receivables. These instruments are initially recognized at fair value. Direct and incremental transaction costs are expensed immediately. They are subsequently valued at amortized cost using the effective interest method less any provision for impairment.

Financial Instruments (continued)

Available for Sale

Available for sale assets are non-derivative financial assets that are designated as available for sale or are not categorized into any of the other categories described above. Investments in equity instruments and debt securities have been classified as available for sale. They are initially recognized at fair value. Direct and incremental transaction costs are expensed immediately. They are subsequently held at fair value with gains and losses arising from changes in fair value being recognized in other comprehensive income in the Statement of Comprehensive Income when they have a quoted market price in an active market. Where a decline in the fair value is determined to be other than temporary, the amount of the loss is removed from other comprehensive income and recognized in the Statement of Operations. Investments in equity instruments classified as available for sale that do not have a quoted market price in an active market are measured at cost less any provision for impairment.

Other Financial Liabilities

Other financial liabilities are non-derivative financial liabilities and include accounts payable and accruals, due to reinsurers, and due to facility association. These instruments are initially recognized at fair value. Direct and incremental transaction costs are expensed immediately. They are subsequently measured at amortized cost using the effective interest method.

Fair Values

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values are determined by reference to quoted bid or asking prices as appropriate, in the most advantageous active market for that instrument to which the company has immediate access.

The estimated fair value of bonds and debentures and pooled funds are based on quoted market values. The estimated fair value of equities are determined using last bid price. The company has reviewed the values of the above investments and has determined that there are no impairments that are other than temporary due to the current economic downturn.

1. Change in accounting policies

Effective January 1, 2008, the company reviewed the amortization policy of capital assets and changed the amortization method from declining balance to straight line basis. This change in accounting estimate, applied prospectively, decreased amortization expense by $143,900 for the year ended December 31, 2008.

On January 1, 2008, the Company adopted three new Canadian Institute of Chartered Accountants (CICA) Handbook Sections: Section 1535, Capital Disclosures; Section 3862, Financial Instruments – Disclosures; and Section 3863, Financial Instruments – Presentation.

Section 1535 requires disclosure of any entity's objectives, policies, and processes for managing capital; information about what the entity regards as capital; whether the company has complied with any external capital requirements; and the consequences of not complying with these capital requirements.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation. Section 3863 carries forward unchanged the presentation requirements of Section 3861 while Section 3862 requires enhanced financial instrument disclosures focusing on disclosures related to the nature and extent of risks arising from financial instruments and how the entity manages those risks.

Since the purpose of these new standards is to enhance disclosure requirements, they do not have a financial impact on the Company and prior year financial statements have not been restated.

On January 1, 2007 the company adopted new accounting standards that were issued by the Canadian Institute of Chartered Accountants ("CICA"). These standards were: Comprehensive Income (handbook "Section 1530"), Financial Instruments – Recognition and Measurement (handbook "Section 3855"), and Financial Instruments – Disclosure and Presentation (handbook "Section 3861"). The adoption of these new standards resulted in changes in the accounting for financial assets and liabilities, non-financial derivatives, as well as the recognition of certain transition adjustments that have been recorded in the opening retained earnings or opening accumulated other comprehensive income. The comparative amounts for prior periods have not been restated as required by the transition requirements. The impact as at January 1, 2007 of adopting these standards resulted in an increase to investments of $4,099,191, a decrease to future tax assets of $902,000 and an increase to opening accumulated comprehensive income of $3,197,191.

2. Cash

The company's bank accounts are held at one Canadian chartered bank. The bank accounts earn interest at a rate of prime less 2.25%.

3. Investments - available for sale

The carrying value of bonds and equities by issuer and industry sector as at December 31 is shown in the following table. The carrying values are equal to their fair values.

	2008		2007	
	Cost	**Fair Value**	Cost	Fair Value
Bonds issued by:				
Federal	**$ 1,235,816**	**$ 1,329,384**	$ 1,245,189	$ 1,250,306
Provincial	**10,880,621**	**11,178,371**	10,484,011	10,636,807
Municipal	**3,438,759**	**3,705,090**	4,249,192	4,445,271
Corporate				
A or better	**7,935,048**	**7,589,135**	7,029,582	7,075,611
BB+	**1,022,899**	**912,907**	1,027,782	908,489
	24,513,143	**24,714,887**	24,035,756	24,316,484
Equity investments				
Canadian common	**4,767,058**	**5,300,323**	3,872,371	6,797,836
U.S. equities	**665,736**	**493,318**	665,736	650,115
Pooled funds	**3,659,616**	**3,256,596**	3,512,313	3,433,141
Other	**-**	**-**	247,000	247,000
	9,092,410	**9,050,237**	8,297,420	11,128,092
Other investments				
Canada Treasury Bills	**-**	**-**	4,105,921	4,105,921
Bankers acceptances	**3,913,472**	**3,913,472**	-	-
Debentures	**112,500**	**112,500**	1,000,000	1,000,000
Fire Mutuals Guarantee Fund	**39,861**	**39,861**	38,574	38,574
	4,065,833	**4,065,833**	5,144,495	5,144,495
Total	**$ 37,671,386**	**$ 37,830,957**	$ 37,477,671	$ 40,589,071

The maximum exposure to credit risk would be the fair value as shown above.

3. Investments (continued)

	2008		2007	
	Cost	**Fair Value**	Cost	Fair Value
Bonds - maturity profile				
Maturing within one year	**$ 3,426,918**	**$ 3,502,007**	$ 2,068,865	$ 2,091,000
Maturing between one and five years	**10,462,427**	**10,637,647**	11,070,452	11,340,785
Maturing over five years	**10,623,798**	**10,575,233**	10,896,439	10,884,699
	$ 24,513,143	**$ 24,714,887**	$ 24,035,756	$ 24,316,484

Included in investments are debentures for which it was determined that losses in value were other than a temporary decline. These debentures were written down to their estimated fair value at December 31, 2008. The estimated fair value was calculated based on past recoveries on similar debentures in other industries. Estimates of recoverable amounts are subjective and do not necessarily result in precise determinations. Actual results could differ from management's best estimates as additional information becomes available in the future. The amount of the impairment recorded in the financial statements for the year ended December 31, 2008 was $887,500 (2007 - $125,000).

Included in investments are other equity investments for which it was determined that losses in value were other than a temporary decline. These other equity investments consisted of shares in Group#1 Financial Services and Farm Mutual Financial Services. The estimated fair value was calculated based on past recoveries on similar equity investments in other industries. Estimates of recoverable amounts are subjective and do not necessarily result in precise determinations. Actual results could differ from management's best estimates as additional information becomes available in the future. The amount of the impairment recorded in the financial statements for the year ended December 31, 2008 was $210,000 (2007 - $0).

The administrator of the Farm Mutual Pooled Funds held by the company entered bankruptcy protection during the year. Due to the uncertainty surrounding the bankruptcy, the custodian of these funds has frozen any contributions or withdrawals by the unit holders. The funds continue to be managed according to the investment mandate, but no purchase or sale of the units will be allowed until the uncertainty is resolved.

4. Capital assets

	2008		2007	
	Cost	**Accumulated Amortization**	Cost	Accumulated Amortization
Land and land improvements	**$ 367,121**	**$ -**	$ 520,867	$ -
Building	**3,067,143**	**61,343**	1,397,232	248,627
Parking lot	**36,750**	**1,838**	41,757	11,814
Computer equipment	**137,281**	**57,231**	205,653	136,697
Office furniture and equipment	**347,985**	**55,537**	193,417	130,623
Signs	**50,723**	**2,029**	-	-
	$ 4,007,003	**$ 177,978**	$ 2,358,926	$ 527,761
Net Book Value		**$ 3,829,025**		$ 1,831,165

Amortization in the amount of $144,500 (2007-$83,500) is included in other expenses on the Statement of Operations.

During the prior year, the company obtained an appraisal for the previous office building and adjacent vacant lots to assist in the expected disposal of these assets once the current office building was completed. From this valuation, it was determined that the carrying values of these assets exceeded their fair value and the assets were therefore written down to their appraised value. The write down was reflected on the statement of operations under asset impairment charges.

5. Unpaid claims

The process of determining the provision for unpaid claims and adjusting expenses, and related amounts recoverable, involves the risk that the actual results will deviate, perhaps substantially, from the best estimates made by the company. The deviation arises because all events affecting the ultimate settlement value of claims are not known at the time the unpaid claims liability is established.

6. Underwriting policy

The company follows the policy of underwriting and reinsuring contracts of insurance which limits the liability of the company to a maximum amount on any one claim of $200,000 ($200,000 in 2007) in the event of a property claim and an amount of $150,000 ($150,000 in 2007) in the event of a liability claim and an amount of $200,000 ($200,000 in 2007) in the event of an automobile claim and an amount of $60,000 ($60,000 in 2007) in the event of a farmers' accident claim. The company is also liable for 10% of any additional amount per claim to a maximum of $1,000,000. In addition, the company has obtained reinsurance which limits the company's liability to $600,000 ($600,000 in 2007) in the event of a series of property claims arising out of a single occurrence. The reinsurance contracts also contain a "stop-loss" provision which limits the company's total liability claims occurring in the year.

7. Pension plan

Employees of the company are members of the multi-employer defined contribution plan held with the Ontario Mutual Insurance Association. Contributions made during the year on behalf of the employees amounted to $64,840 (2007 - $93,905) and are included as an expense in the Statement of Operations. The prior year contributions includes a $37,143 top-up payment to the pension plan.

8. Rate regulation

The company is subject to rate regulation in the automobile business that it writes. Before automobile insurance rates can be changed, a rate filing is prepared as a combined filing for most Ontario Farm Mutuals by the Farm Mutual Reinsurance Plan Inc. (FMRP). The rate filing must include actuarial justification for the rate increases or decreases. All rate filings are approved or denied by the Financial Services Commission of Ontario.

Rate regulation can affect the automobile revenues that are earned by the Company. The actual impact of rate regulation would depend on the competitive environment at the time.

9. Capital management

The Company’s objectives with respect to capital management are to maintain a capital base that is structured to exceed regulatory requirements and to best utilize capital allocations. Reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable. To limit their potential impact, catastrophe coverage limits Kent & Essex Mutual’s exposure to $600,000 plus 5% of the remaining loss. The $600,000 net retained amount represents approximately 2% of company’s capital. For the purpose of capital management, the Company has defined capital as policyholders' equity excluding accumulated other comprehensive income.

The regulators measure the financial strength of property and casualty insurers using a minimum capital test (MCT). The regulators generally expect property and casualty companies to comply with capital adequacy requirements. This test compares a company’s capital against the risk profile of the organization. The risk-based capital adequacy framework assesses the risk of assets, policy liabilities and other exposures by applying various factors. The regulator indicates that the company should produce a minimum MCT of 150%. The regular has the authority to request more extensive reporting and can place restrictions on the Company’s operations if deemed necessary.

In an actuarial study done, the net risk ratio was shown to have a high correlation to the MCT. As a result of these findings the company uses the net risk ratio to monitor capital adequacy.

The Company measures its financial strength by examining its net premiums written to capital, as defined above, ratio or net risk ratio. For the year ended December 31, 2008 the company's ratio was 0.43 (2007 – 0.41). In 2008 for every $0.43 of net premium written the Company has $1.00 of capital in support of the net premium. In 2007 for every $0.41 of net premium written the Company has $1.00 of capital in support of the net premium.

10. Financial instrument risk management

Credit risk

Credit risk is the risk of loss due to the inability or unwillingness of a borrower or counterparty to fulfill its payment obligation to the Company. The Company is exposed to this risk relating to its debt holdings in its investment portfolio and the reliance on reinsurers to make payment when certain loss conditions are met.

The Company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The bond portfolio remains very high quality with 96% of the bonds rated A or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer. Management monitors the creditworthiness of FMRP by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Accounts receivables are short-term in nature and are not subject to material credit risk.

The maximum exposure to credit risk and concentration of this risk is outlined in note 3.

There have been no significant changes from the previous period in the exposure to risk or policies procedures and methods used to measure the risk.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of market factors. Market factors include three types of risk: currency risk, interest rate risk, and equity risk.

Our company's investment policy operates within the guidelines of the Ontario Insurance Act. An investment policy is in place and its application is monitored by the Investment Committee and the Board of Directors. Diversification techniques are utilized to minimize risk. The Policy limits the investment in any one corporate issuer to a maximum of 5% of the Company's total assets.

Currency risk

Currency risk relates to the company operating in different currencies and converting non Canadian earnings at different points in time at different foreign exchange levels when adverse changes in foreign currency exchange rates occur.

The Company's foreign exchange risk is related to its stock holdings. The company limits its holdings in foreign equity to 10% of equities in accordance with its investment policy. At December 31, 2008 the foreign portion of the equity portfolio is 7.8%. Foreign currency changes are monitored by the investment committee and holdings are adjusted when out of balance with investment policy. A 1% change in the value of the United States dollar would affect the fair value of stocks by $4,933 which would be reflected in Other Comprehensive Income.

There have been no significant changes from the previous period in the exposure to risk or policies, procedures and methods used to measure the risk.

10. Financial instrument risk management (continued)

Interest rate risk

Interest rate risk is the potential for financial loss caused by fluctuations in fair value or future cash flows of financial instruments because of changes in market interest rates.

The company is exposed to this risk through its interest bearing investments (T-Bills, BAs, Bonds).

Historical data and current information is used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. However, because a significant portion of the Company's assets relate to its capital rather than liabilities, the value of its interest rate based assets exceeds its interest rate based liabilities. As a result, generally, the Company's investment income will move with interest rates over the medium to long-term with short term interest rate fluctuations creating unrealized gain or losses in Other Comprehensive Income. There are no occurrences where interest would be charged on liabilities, therefore, little protection is needed to ensure the fair market value of assets will be offset by a similar change in liabilities due to an interest rate change.

The objective and policies and procedures for managing interest rate risk is to diversify the bond portfolio in such a way that the bonds are a portfolio laddered over 10 years. One tenth of the bond portfolio would come due each year and be reinvested. This protects the company from fluctuations in the interest rates.

At December 31, 2008, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds by $1,375,508. For bonds that the Company did not sell during the year, the change during the year and changes prior to the year would be recognized as Other Comprehensive Income during the period.

There have been no significant changes from the previous period in the exposure to risk or policies, procedures and methods used to measure the risk.

Equity risk

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The company is exposed to this risk through its equity holdings within its investment portfolio.

The Company's portfolio includes Canadian stocks with fair values that move with the Toronto Stock Exchange Composite Index and United States stocks with fair values that move with the S&P 500 Index. A 10% movement in the stock markets with all other variables held constant would have an estimated affect on the fair values of the Company's Canadian common and United States common of $631,812. For stocks that the company did not sell during the period, the change would be recognized in the asset value and in other comprehensive income. For stocks that the company did sell during the period, the change during the period and changes prior to the period would be recognized as net realized gains in income during the period.

The Company limits the total percentage of equities as part of the investment portfolio to a maximum of 25% with a target of 15%. At December 31, 2008 the equity portion of our portfolio was 16.7%. The Company invests in equities only that are traded on the S&P/TSX 60 Index and it does not invest in other insurance companies traded on the Index.

10. Financial instrument risk management (continued)

Liquidity risk

Liquidity risk is the risk of loss from not having access to sufficient fund to meet both expected and unexpected cash demands. The Company mitigates this risk by monitoring cash activities and expected outflows. The Company's current liabilities arise as claims are made. The Company does not have material liabilities that can be called unexpectedly at the demand of a lender or client. We have no material commitments for capital expenditures and there is no need for such expenditures in the normal course of business. Claim payments are funded by current operating cash flow and as required short term investments held in T-Bill or Bankers Acceptances. As required, the Company has a policy to invest a portion of the investment portfolio in short term investments to a maximum of 10% with a target of 5%. At December 31, 2008 the short term portion of our investment portfolio was 10.3%. The Company is holding more of its portfolio in short term investments due to the unfavourable bond yields currently in the market, not wanting to lock in at a poor rate for a fixed term.

There have been no significant changes from the previous period in the exposure to risk or policies procedures and methods used to measure the risk.

11. New accounting pronouncements

Financial Statement Concepts

CICA Handbook Section 1000, Financial Statement Concepts has been amended to focus on the capitalization of costs that truly meet the definition of an asset and de-emphasizes the matching principle.

The revised requirements are effective for annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. The company is currently evaluating the impact of the adoption of this change on the disclosure within its financial statements.

International Financial Reporting Standards (IFRS)

The Accounting Standards Board has confirmed that all publicly accountable enterprises will have to comply with IFRS for fiscal years beginning on or after January 1, 2011. We understand there to be differences between current Canadian GAAP and IFRS, and have undertaken a project to understand the possible future effects on the financial statements.