STATE OF NORTH DAKOTA

BISMARCK, NORTH DAKOTA

REPORT OF EXAMINATION

OF

WALSH COUNTY MUTUAL INSURANCE COMPANY MINTO, NORTH DAKOTA

AS OF DECEMBER 31, 2004

STATE OF NORTH DAKOTA

DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Walsh County Mutual Insurance Company

Minto, North Dakota

as of December 31, 2004, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal at my office in the City of Bismarck, this 25th day of January, 2005.

Jim Poolman
Commissioner of Insurance

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Minto, North Dakota
December 5, 2005

Honorable Jim Poolman
Commissioner of Insurance
North Dakota Insurance Department
600 East Boulevard Avenue
Bismarck, ND 58505

Dear Sir:

Pursuant to your instructions and in accordance with the North Dakota Insurance Code, an examination was made of the condition and affairs of the

Walsh County Mutual Insurance Company

Minto, North Dakota

as of December 31, 2004.

Walsh County Mutual Insurance Company, Minto, North Dakota, hereinafter referred to as the Company, was last examined as of December 31, 1999, by a representative of the State of North Dakota.

SCOPE OF EXAMINATION

The current examination covers the period January 1, 2000, through December 31, 2004, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

This examination was made in accordance with the practices and procedures promulgated by the National Association of Insurance Commissioners with due regard to the statutory requirements of the insurance laws, rules, and regulations of the State of North Dakota.

Examination procedures included a verification and evaluation of assets, a determination of liabilities, and reviews of corporate records, claim files, and other records relating to Company operation practices.

Comments on Previous Statutory Examination

The following are the recommendations contained in the prior examination reports dated December 31, 1999, with which the Company has not complied:

- That the Company keep minutes of Investment Committee meetings to document approval of investment transactions.

- That the Company maintain supporting documents for all cash disbursements.

HISTORY

The Company was incorporated and commenced business June 27, 1885, as the "Walsh County Farmers Mutual Hail and Fire Insurance Company," with its home office and principal place of business at Minto, North Dakota.

At the annual meeting of the membership held June 21, 1968, the Articles of Incorporation and Bylaws were amended changing the name of the Company to read the "Walsh County Mutual Insurance Company," with its territory to include all of Walsh, Grand Forks, Nelson, Ramsey, Cavalier, and Pembina Counties.

The Company is organized pursuant to the provisions of N.D. Cent. Code Chapter 26.1-13 to insure against all of the risks and to possess all of the powers and to be subject to all of the liabilities and duties of a county mutual insurance company as now provided in N.D. Cent. Code Chapter 26.1-13 and as the same may be from time to time amended in the future. The Company's term of existence is on a perpetual basis in accordance with N.D. Cent. Code § 26.1-13-03.

MANAGEMENT AND CONTROL

The Company is controlled by its membership. Any person owning property within the limits of the territory within which the Company is authorized to transact business may become a member of the Company and be entitled to all the rights and privileges of membership. No person who does not reside within such territorial limits shall become a director of the Company.

Directors

According to the Bylaws the management of the Company's affairs, business, and property is to be vested in a Board of Directors composed of five members elected for staggered terms of three years each at the annual meeting of the membership. A majority of the entire Board of Directors constitutes a quorum for the transaction of business.

Directors duly elected and serving the Company at December 31, 2004, were as follows:

Name and Residence	Term Expires	Occupation
Cory Kouba Lankin, ND	2007	Farmer
William Suda Grafton, ND	2006	Farmer
Louis Kadlec Pisek, ND	2005	Farmer
Joe Zikmund Forest River, ND	2007	Farmer
Don Barclay Minto, ND	2005	Farmer

Officers

Officers are elected at the organizational meeting of the Board of Directors by a majority vote for a period of one year or until their successors are elected and qualified. Officers serving at December 31, 2004, were as follows:

Name	Office
William Suda	President
Louis Kadlec	Vice President
James Schanilec	Secretary-Treasurer

Investment Committee

As appointed by the Board of Directors, the following individuals served on the Investment Committee at December 31, 2004:

Name	Title
William Suda	President
Louis Kadlec	Vice President
James Schanilec	Secretary-Treasurer

CORPORATE RECORDS

The minutes of the meetings held by the membership and directors during the years under examination were reviewed for compliance with the Articles of Incorporation, Bylaws, and statutory requirements.

Members

During the period under examination the annual meetings of the membership were held on the following dates: March 31, 2000; March 30, 2001; March 27, 2002; March 28, 2003; and March 26, 2004.

Directors

During the period under examination the Board of Directors held four meetings in each of the years 2000, 2001, 2003 and five meetings in 2002 and 2004.

Amendments to Articles of Incorporation and Bylaws

There were no amendments to the Articles of Incorporation or Bylaws during the period under examination.

Prior Approval of Investments

An Investment Committee is appointed by the Board of Directors on an annual basis; however, there were no recorded minutes of that committee during the period under examination. In addition, the minutes of the Board of Directors do not always reflect approval of investment transactions as required by North Dakota insurance law. N.D. Cent. Code § 26.1-05-18 requires the Board of Directors or a board-appointed Investment Committee to authorize an investment transaction before it is made. The North Dakota Insurance Department has deemed board or committee approvals on no less than a quarterly basis to be in compliance with the law when the requirements of N.D. Admin. Code § 45-03-12-05 are followed.

It is recommended that the Company implement a procedure pursuant to N.D. Admin. Code § 45-03-12-05 to provide for quarterly authorization of investment transactions by the Board of Directors or the Investment Committee. It is recommended that Board minutes and Investment Committee minutes reflect approval of all investment transactions.

FIDELITY BOND AND OTHER INSURANCE

At December 31, 2004, there was in force a continuous position schedule fidelity bond covering the Secretary-Treasurer for the faithful performance of duty in the amount of $25,000.

The coverage does not meet the minimum amount of fidelity insurance suggested by the guidance in the National Association of Insurance Commissioners Financial Examiners Handbook.

It is recommended that the Company increase their fidelity bond coverage to the minimum $50,000 amount prescribed by the NAIC.

The Company also had in force a directors and officers liability insurance policy providing a limit of liability of $1,000,000 each policy year. Each claim is subject to a $2,500 deductible. The policy provides coverage for errors or omissions in the performance of professional services and wrongful acts of a director or officer while acting solely in their individual or collective capacities as directors and officers.

Insurance coverage on the Company's home office building was reviewed and appeared to be adequate.

TERRITORY AND PLAN OF OPERATION

At December 31, 2004, the Company was authorized to transact business in the following counties:

Cavalier	Nelson	Ramsey
Grand Forks	Pembina	Walsh

At December 31, 2004, the Company had 35 licensed agents.

SIGNIFICANT OPERATING RESULTS

Growth

The following exhibit reflects the growth of the Company over the five-year period under examination. Data with respect to the years 2000-2003 is as compiled from home office copies of the filed Annual Statements. Data for the year 2004 reflects the results of this examination. The operational results are presented on a cash basis.

Year	Admitted Assets	Total Liabilities	Surplus as Regards Policyholders	Net Premiums Written	Underwriting Deductions	Investment and Other Income	Net Income (Loss)
2000	$796,182	$551,704	$244,478	$496,301	$493,813	$79,418	$81,905
2001	871,053	477,434	393,619	494,013	466,792	71,216	98,437
2002	1,118,166	619,396	498,771	587,879	525,245	62,443	125,077
2003	1,177,696	618,548	559,148	633,553	643,957	72,385	61,981
2004	1,392,354	654,647	737,707	702,032	420,331	88,491	370,192

Operating Ratios

The underwriting ratios presented below are on a cash basis and encompass the five-year period ending December 31, 2004:

	2000	2001	2002	2003	2004
Premiums	100.0%	100.0%	100.0%	100.0%	100.0%
Deductions:					
Losses and Loss Adjustment	59.3%	54.6%	48.6%	59.0%	28.1%
Underwriting Expenses	40.2%	39.9%	44.9%	47.8%	35.9%
Total Deductions	99.5%	94.5%	93.5%	106.8%	64.0%
Net Underwriting Gain (Loss)	0.5%	5.5%	6.5%	(6.8%)	36.0%

INSURANCE PRODUCTS AND RELATED PRACTICES

During the course of this examination, a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to policyholders and claimants. This review was general in nature and substantially less in scope than a full scope market conduct examination.

This review was directed at business practices in the following major areas: Advertising and Sales and Treatment of Policyholders.

Advertising: The advertising material was reviewed and no exceptions were noted.

<u>Claims:</u> A limited review of claim files indicated that the Company paid claims promptly and within policy provisions upon receipt of satisfactory proof of loss or damage.

The Company's claim register does not contain the following fields normally found in a claims register: claim number, date reported, amount paid, date paid, date closed and reinsurance received. These fields provide documentation supporting paid losses, the year-end claim reserves and facilitate review of claim settlement practices.

It is recommended that the Company expand its claims register to include columns for a claim number, date reported, amount paid, date paid, date closed and reinsurance received and that it enter claims in the register in report date order.

OPERATING AGREEMENTS

<u>Universal Adjustment Services, Inc.</u>

In March 2004 the Company and four other North Dakota domestic county mutual insurance companies entered into a contract with Universal Insurance Services, Inc. (Universal) for the purpose of obtaining claims adjusting and risk review services on an extended basis.

The contract provides for Universal to perform a maximum of 450 claim adjustments or risk reviews per year. Claims adjusted by Universal above that number will be billed to the incurring entity at the rate of $30 per hour plus mileage and per diem.

For services provided, Universal shall receive the annual sum of $60,000 to be paid in monthly installments of $5,000 each. (For year 2004, the sum was prorated to $45,000.) In addition to the $60,000 annual compensation, Universal shall receive additional payments of $3,750 in 2004 and $5,000 in each of the years 2005 and 2006.

The agreement terminates on December 31, 2006, or earlier if Universal fails to perform its contractual obligations. The contract shall continue and be binding upon any one or more of the five insurance companies signing this contract if they participate in a merger or consolidation.

For 2004, the Company's share of the $5,000 monthly charge was $1,612 per month.

REINSURANCE

The Company's reinsurance treaty in force at December 31, 2004, is summarized below.

Nonaffiliated Ceding Contract:

1.	Type:	Excess
	Reinsurer:	Grinnell Mutual Reinsurance Company
	Scope:	Fire, Lightning, Windstorm, Hail, and Extended Coverages:

	(A)	Individual Occurrence of Loss Excess - Covers all risks written by the Company in excess of $75,000 retention subject to the following limits:	
		Dwellings	$500,000
		Farm Outbuildings	750,000
		Livestock/Poultry/Horse Operations	500,000
		Commercial and Public Property	500,000
	(B)	Aggregate Excess - Provides coverage 100 percent of the Company's aggregate net losses in excess of a defined retention limit. The retention limit for 2004 was $391,989.	
Premium:	(A)	Individual Occurrence of Loss Excess - The 2004 annual premium was $.3806 per $1,000 of adjusted gross fire risks in force.	
	(B)	Aggregate Excess - The 2004 annual premium was $.8693 per $1,000 of gross fire risks in force.	
Commissions:	None		
Termination Date:	The agreement may be terminated only as of the last day of any calendar year by either party upon 90 days notice in writing.		

The contract contained the insolvency clause required by N.D. Cent. Code § 26.1-02-21 and all of the clauses required by the NAIC's *Accounting Practices and Procedures Manual* except for the entire contract clause.

It is recommended that the Company amend the reinsurance agreement with Grinnell Mutual Reinsurance Company to include an entire contract clause.

ACCOUNTS AND RECORDS

The general books of the Company are on a cash basis and consist of an income and disbursement journal, policy record, claims register, a corporate record book and a record of agent production.

A trial balance was prepared as of December 31, 2004, for the purpose of tracing it to the Annual Statement. No exceptions were noted.

The following exceptions were noted with regard to Accounts and Records:

<u>**Cash Controls:**</u> The Company does not require two signatures for check issuance, unissued checks are not kept in a secure location and restricted endorsements (for deposit only) are not placed on checks upon receipt.

It is recommended that the Company require two signatures on all checks, or on all checks in excess of a minimum amount established by the Board, that all unissued

checks be stored in a secure location, and that the Company place a restrictive endorsement on every check upon receipt.

Cash Disbursements:

- The Company could not always provide documents supporting certain cash disbursements.
- Expenses were not always classified in accordance with the *Annual Statement Instruction Manual.*
- The amount recorded in the cash disbursement journal did not always agree with the amount on the cancelled check.

It is recommended that the Company maintain supporting documents for all cash disbursements, that the Company classify expenses in accordance with the *Annual Statement Instruction Manual*, and that the Company reconcile subsidiary records to primary records on a periodic basis.

Policy Fees: The Company reported policy fees in its Annual Statement as a write-in item on line 11 of page 2 instead of on line 1 of page 2 (gross premium income).

It is recommended that the Company report policy fees in the Annual Statement as premium income on line 1 of page 2 rather than as a page 2 write-in item.

Uncollected Agent's Balances: Review of reinsurance billings and cash receipt journals determined that an agent of the Company owed $886.31 to the Company at December 31, 2004, for net liability premiums not remitted to the Company for policies with effective dates in years 2002 and 2003.

It is recommended that the Company establish procedures to insure that premiums for all in-force policies are received on a timely basis from policyholders and agents.

FINANCIAL STATEMENTS

The following statements reflect the financial condition of the Company as of December 31, 2004, as determined by this examination and its operating results for the year then ended.

Walsh County Mutual Insurance Company
Assets, Liabilities, and Surplus
December 31, 2004

ASSETS			
LEDGER ASSETS:			
Bonds	$ 768,368.26		
Stocks	295,835.19		
Real Estate	4,229.42		
Checking Account	83,462.99		
Cash on Deposit	262,961.50		
Furniture, Fixtures & Automobiles	2,220.00		
TOTAL LEDGER ASSETS		$1,417,077.36	
NONLEDGER ASSETS:			
Interest Due and Accrued on Bonds	$ 10,589.54		
Market Value of Stocks over Book Value	20,764.32		
Agents Balances	886.31		
TOTAL NONLEDGER ASSETS		32,240.17	
DEDUCT: ASSETS NOT ADMITTED			
Furniture, Fixtures & Automobiles	$ 2,220.00		
Market Value of Stocks in Excess of Statutory Limitations	53,857.20		
Agents Balances	886.31		
TOTAL NONADMITTED ASSETS		56,963.51	
TOTAL NET ADMITTED ASSETS			$1,392,354.02
LIABILITIES			
Unpaid Losses	$ 62,322.21		
Unearned Premium Reserve	481,262.93		
Unpaid Taxes	6,750.32		
Amounts Withheld	700.00		
Federal Income Tax Due and Accrued	74,745.00		
Unpaid General Expenses	524.15		
Reinsurance Premiums Due and Payable	28,342.07		
TOTAL LIABILITIES		$654,646.68	
SURPLUS TO POLICYHOLDERS		737,707.34	
TOTAL LIABILITIES AND SURPLUS			$1,392,354.02

Walsh County Mutual Insurance Company
Statement of Income and Disbursements
(Cash Basis)
For the Year 2004

INCOME:			
Gross Premium Income	$943,116.66		
Less: Return Premiums	19,873.63		
Premiums for Reinsurance Ceded	221,210.70		
NET PREMIUM INCOME		$702,032.33	
Interest on Bonds		28,901.55	
Dividends on Stocks		8,580.72	
Gross Rent From Company's Property		3,000.00	
Interest on Cash on Deposit		5,835.42	
Gross Liability Commissions Received		21,268.39	
Tax Refund		20,905.00	
TOTAL INCOME RECEIPTS			$790,523.41
DISBURSEMENTS:			
Gross Losses Paid and Incurred in 2004	$129,417.63		
Gross Losses Paid in 2004 But Incurred in Prior Years	119,562.44		
Deduct: Salvage	2,000.00		
Reinsurance	82,612.00		
NET LOSSES PAID		$164,368.07	
Claim Adjustment Expenses		20,008.07	
Commissions Paid to Agents		143,427.87	
Directors Fees and Expenses		2,760.00	
Salaries to Employees		41,229.50	
Printing, Stationary, and Office Supplies		1,956.60	
Rent and Rent Items		3,000.00	
Real Estate Expenses		4,448.17	
Taxes on Real Estate		522.61	
State and Local Insurance Taxes		13,393.00	
Insurance Department Licenses and Fees		500.00	
Payroll Taxes		3,154.11	
Legal Fees and Auditing		2,825.00	
Travel and Travel Items		1,165.55	
Advertising		1,888.79	
Dues and Donations		2,968.00	
Insurance and Bonds		4,352.67	
Postage, Telephone, and Bank Charges		4,475.19	
Employee Relations and Welfare		461.37	
Data Processing Expenses		2,129.42	
Miscellaneous		1,297.08	
TOTAL FUNDS DISBURSED			420,331.07
NET INCOME			$370,192.34

COMMENTS TO THE FINANCIAL STATEMENTS

Financial statement balances at December 31, 2004, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Bonds **$768,368.26**

The following schedule presents the classification, market value, actual cost, par value, and admitted value of all bonds owned by the Company as of December 31, 2004:

Classification	Market Value	Actual Cost	Par Value	Admitted and Investment Value
U.S. Government	$343,241.00	$294,379.35	$297,254.81	$296,828.89
Industrial & Miscellaneous	471,539.37	471,539.37	471,539.37	471,539.37
Totals	$814,780.37	$765,918.72	$768,794.18	$768,368.26

Market values were determined on the basis of methods established by the Committee on Valuation of Securities of the NAIC. The investment or admitted value of bonds at December 31, 2004, represented book value.

The admitted value of bonds as determined by this examination is $383,736.82 more than the amount reported by the Company in its 2004 Annual Statement. The increase consists of the following two items:

- The Examiner reclassified shares in the Bond Fund of America from bonds to common stocks resulting in a decrease in the bond caption of $87,802.55.
- The Examiner reclassified four long-term certificates of deposit to this caption from Cash on Deposit resulting in an increase to the bond caption of $471,539.37. The CDs were classified as bonds in accordance with the criteria set forth in Bulletin 2003-3.

The following differences were noted with regard to the Company's reporting of bonds:

- Page 4 – Increase/Decrease by Adjustment – All of the bonds owned at December 31, 2004, were purchased at a premium or discount; however, the Company recorded book value adjustments for only one issue.
- Page 4 – Actual Cost – The broker's ticket shows actual cost of a FNMA bond to be $99,800 not $100,000 as reported by the Company.
- Page 4 CUSIP and NAIC Designation Column – The CUSIP number column and the NAIC designation column were not completed.
- Page 4 Description – The description column does not contain the maturity date. One issue should have been described as FHLMC Gold Pool rather than as a FNMA.

- Page 4 – Overstatement of Actual Cost/Par Value – The actual cost and par value of the FHLMC Gold Pool was overstated by over $25,000 at December 31, 2004.

It is recommended that the Company record annual adjustments to the book value of bonds for the accrual of bond discount and the amortization of bond premium as required by the *Annual Statement Instruction Manual.*

It is recommended that bond investments, including CUSIP number, bond description and NAIC designation be reported in subsequent annual statements in conformity with the *Annual Statement Instruction Manual* and that the amounts reported agree with supporting documentation.

Stocks **$295,835.19**

Market Value of Stocks over Book Value **$20,764.32**

Market Value of Stocks in Excess of Statutory Limitations **$53,857.20**

The following schedule discloses the classification, number of shares, cost and book value and market value of all shares owned at year end:

Classification	Number of Shares	Cost and Book Value	Market Value
Stock and Bond Mutual Funds	13,549.37	$264,487.78	$285,252.37
Money Market Mutual Funds	31,347.41	31,347.41	31,347.41
TOTALS	44,896.78	$295,835.19	$316,599.78

Book values were verified to the accounting records and statements from brokers. Market values were determined using unit prices listed in the *Wall Street Journal* and other independent sources.

The cost and book value of stocks as determined by this examination is $119,149.96 more than the amount reported by the Company in its 2004 Annual Statement. The increase consists of the following items:

- The Examiner reclassified shares in the Bond Fund of America from bonds to common stocks resulting in an increase in the stock caption of $87,802.55.

- The Examiner reclassified shares in a money market mutual fund from cash on deposit to common stocks resulting in an increase in the stock caption of $31,347.41.

- The Examiner increased the Market Value of Stocks over Book Value in the amount of $95.32 due to the reclassification of the Bond Fund of America from a bond to a stock.

N.D. Cent. Code § 26.1-05-19(21)(a) restricts investments in preferred, guaranteed, and common stocks (includes mutual funds) issued or guaranteed by a single person to an amount not in excess of 3% of the insurance company's admitted assets. At December 31, 2004, the market value of shares in the Income Fund of America, Capital Income Builder and Bond Fund of America exceeded the 3% admitted asset limitation. The aggregate amount by which the three funds exceeded the 3% limitation was $155,091.99.

Additional investment authority for investments exceeding statutory limitations is found in N.D. Cent. Code § 26.1-05-19(33), commonly known as the basket clause. It provides additional investment authority allowing insurers to invest funds in investments not specifically authorized elsewhere to an amount that does not exceed either 7% of the company's admitted assets, or the amount equal to the company's capital and surplus in excess of the minimum capital and surplus required by law, whichever is less. The basket clause provided an additional investment authority of $101,234.79 at December 31, 2004.

The Examiner treated the excess of market value over the 3% limitation and the authority provided by the basket clause as a non-admitted asset:

Market Value of Funds over the 3% Limitation	$155,091.99
December 31, 2004 Basket Clause	101,234.79
Non-admitted	$ 53,857.20

It is recommended that the Company review its stock positions for compliance with the limitations set forth in N.D. Cent. Code §§ 26.1-05-19(21)(a) and 26.1-05-19(33) and report a non-admitted asset in its annual statement in the event that the market value of stocks exceeds statutory limitations.

Real Estate **$4,229.42**

Real estate owned consisted of the following item and amount at December 31, 2004:

Classification	Actual Cost	Book Value
Home Office Building	$28,970.75	$4,229.42
Total	$28,970.75	$4,229.42

The Company acquired its home office building in 1961. The December 31, 2004, book value of the home office building consisted of original cost of $12,257.15, capitalized improvements of $14,130.03, and 1985 special assessments of 2,583.57 less accumulated depreciation of $24,741.33.

Checking Account **$83,462.99**

The Examiner prepared a bank reconciliation of the checking account and found an irreconcilable difference between the reported Annual Statement checking account balance of $82,181.42 and the balance confirmed by the bank. The Examiner reconciled the balance on the bank confirmation to the Company's check stub balance of $83,462.99. The increase in this caption in the amount of $1,281.57 is reflected in the changes to "Surplus to Policyholders" of this report.

Cash on Deposit **$262,961.50**

Cash on Deposit was determined by this examination to be in the amount of $262,961.50 or $502,886.78 less than the amount reported on the annual statement. The difference consists of the following items and amounts:

Reclassification of Money Market Mutual Fund to Stocks	$ 31,347.41
Reclassification of Long-term CD's to Bonds	471,539.37
Total	$502,886.78

The Examiner classified shares in the money market mutual fund as common stock in accordance with the *Purposes and Procedures Manual of the NAIC's Valuation of Securities Office*. The Examiner reclassified four long-term certificates of deposit (maturing in over one year) as bonds in accordance with Bulletin 2003-3.

It is recommended that the Company classify all certificates of deposits with a term longer than one year as bonds rather than as cash on deposit if those CDs do not meet the exemption requirements cited in Bulletin 2003-3. It is also recommended that the Company classify shares in money market mutual funds as common stocks.

At December 31, 2004, the Company's deposit in three banks exceeded FDIC insured limits.

It is recommended that the Company limit its deposit in any one banking institution to FDIC insured amounts or obtain insurance protection covering the deposits exceeding FDIC insured limits.

Interest Due and Accrued on Bonds **$10,589.54**

The Company's accrual for interest receivable on bonds was determined by this examination to be in the amount of $10,589.54 or $7,453.33 more than that reported by the Company. The increase is attributable to the following items and amounts:

• Accrued interest on reclassified CDs	$6,786.69
• Accrued interest understatement	666.64
• Total increase	$7,453.33

Interest Due and Accrued on Certificates of Deposit **$0**

Interest Due and Accrued on Certificates of Deposit was determined by this examination to be $0 or $6,786.69 less than what was reported in the Company's annual statement. The decrease is attributable to the accrued interest on the four certificates of deposit that were reclassified as bonds.

Agents Balances (Non-Ledger Asset) **$886.31**

Agents Balances (Non-Admitted Asset) **$886.31**

The Examiner established a non-ledger and non-admitted asset for net liability premiums due from an agent of the Company for two policies issued in years 2002 and 2003. The balances were over 90 days due at December 31, 2004, and were treated by the Examiner as a non-admitted asset. The Company received payment for the overdue premiums during the course of this examination on August 26, 2005.

Unpaid Losses **$62,322.21**

The liability for Unpaid Losses was determined by this examination to be in the amount of $62,322.21 or $41,062.26 less than that reported by the Company. The following schedule shows the Company's reserve for unpaid losses at December 31, 2004, and the reserve development through September 28, 2005.

		Reserve Development		Redundancy
	Company	**Payments**	**Reserves**	**(Inadequacy)**
Case Reserves	$94,634.47	$58,072.21	$2,000.00	$34,562.26
IBNR	8,750.00	1,750,00	500.00	6,500.00
Total	$103,384.47	$59,822.21	$2,500.00	$41,062.26

Unearned Premium Reserve **$481,262.93**

The Company's liability for Unearned Premiums at December 31, 2004 was determined by this examination to be in the amount of $481,262.93 or $1,273.58 less than that estimated by the Company. The unearned premium reserve was calculated using the semi-monthly pro rata method.

Unpaid General Expenses **$524.15**

The liability for Unpaid General Expenses at December 31, 2004, was determined by this examination to be in the amount of $524.15 or $1,265.23 less than that reported by the Company in its 2004 Annual Statement.

In its 2004 Annual Statement, the Company incorrectly classified the liability for real estate taxes, federal and state unemployment taxes and payroll withholdings for state tax on line 37 of page 3 as Unpaid General Expenses.

It is recommended that the Company report the liability for real estate taxes and state and federal unemployment taxes as Unpaid Taxes on line 35 of page 3 and report payroll withholdings as a write-in liability on page 3 under the caption of Amounts Withheld.

Amounts Withheld **$700.00**

The liability for Amounts Withheld at December 31, 2004, was determined by this examination to be in the amount of $700.00. This liability represents amounts withheld from employee salaries for state income taxes. The Company erroneously reported this liability under the Unpaid General Expenses caption.

Unpaid Taxes **$6,750.32**

The liability for Unpaid Taxes at December 31, 2004, was determined by this examination to be in the amount of $6,750.32 or $73,351.68 less than that reported by the Company in its 2004 Annual Statement. The decrease is attributable to the following items and amounts:

	Company	Examination	Difference
Federal Income Taxes (Reclassified)	$75,920.00	$ 0	$(75,920.00)
2004 Premium Taxes	4,182.00	4,964.00	782.00
2002 & 2003 Premium Taxes	0	989.00	989.00
Real Estate Taxes	0	520.76	520.76
State Workers Compensation	0	166.42	166.42
Federal Unemployment Tax	0	96.63	96.63
State Unemployment Tax	0	13.51	13.51
Total	$80,102.00	$6,750.32	$(73,351.68)

Federal Income Taxes Due and Accrued **$74,745.00**

The liability for Federal Income Taxes Due and Accrued was determined by this examination to be in the amount of $74,745 based on 2004 federal income tax return as follows:

2004 Federal Income Tax	$88,745
Less: Credit from 2003 overpayment	14,000
Tax Due	$74,745

In its 2004 Annual Statement, the Company incorrectly classified its federal income tax liability as Unpaid Taxes on line 35 of page 3.

It is recommended that the Company report the liability for federal income taxes as a write-in item on line 32 or line 41 of page 3.

Surplus to Policyholders

Surplus to Policyholders was determined by this examination to be in the amount of $737,707.34 or $10,305.92 less than the amount reported by the Company. Adjustments to surplus are shown in the following schedule:

Caption	Company	Examination	Increase or (Decrease)
Ledger Assets			
Bonds	$384,631.44	$768,368.26	$383,736.82
Stocks	176,685.23	295,835.19	119,149.96
Checking Account	82,181.42	83,462.99	1,281.57
Cash on Deposit	765,848.28	262,961.50	(502,886.78)
Non-Ledger Assets			
Agents Balances	0	886.31	886.31
Interest Due and Accrued on Bonds	3,136.21	10,589.54	7,453.33
Interest Due and Accrued on CDs	6,786.69	0.00	(6,786.69)
Market Value of Stocks over Book Value	20,669.00	20,764.32	95.32
Non-Admitted Assets			
Agents Balances	0	886.31	(886.31)
Market Value of Stocks in Excess of Statutory Limitations	0	53,857.20	(53,857.20)
Liabilities			
Unpaid Losses	103,384.47	62,322.21	41,062.26
Unearned Premium Reserve	482,536.51	481,262.93	1,273.58
Unpaid General Expenses	1,789.38	524.15	1,265.23
Unpaid Taxes	80,102.00	6,750.32	73,351.68
Amounts Withheld	0	700.00	(700.00)
Federal Income Tax Due and Accrued	0	74,745.00	(74,745.00)
Net Change			**$(10,305.92)**

CONCLUSION

The financial condition of Walsh County Mutual Insurance Company, Minto, North Dakota, as determined by this examination as of December 31, 2004, is summarized as follows:

TOTAL ADMITTED ASSETS		$1,392,354.02
Total Liabilities	$654,646.68	
Surplus to Policyholders	737,707.34	
TOTAL LIABILITIES AND SURPLUS		$1,392,354.02

Since the last examination conducted as of December 31, 1999, the Company's admitted assets have increased $680,003, its total liabilities have increased $255,970 and its surplus as regards policyholders has increased by $424,033.

The examination was performed by Examiner Chad Myhre and the undersigned.

The Examiners express their appreciation for the courteous cooperation extended them during the course of the examination.

Respectfully submitted,

David Weiss

David Weiss, CFE
Examiner
N.D. Insurance Department

SUBSEQUENT EVENTS

At its November 23, 2004, meeting the Board of Directors selected Brad Schanilec to replace Jim Schanilec as Secretary-Treasurer of the Company. The change will take place on November 1, 2005, the date Jim Schanilec retires as Secretary-Treasurer of the Company. The Board also approved a compensation package for the Secretary-Treasurer position which will be determined using a percentage of premiums written.

Brad Schanilec is a former agent for a regional insurance company.

COMMENTS AND RECOMMENDATIONS

It is recommended that the Company implement a procedure pursuant to N.D. Admin. Code § 45-03-12-05 to provide for quarterly authorization of investment transactions by the Board of Directors or the Investment Committee. It is recommended that Board minutes and Investment Committee minutes reflect approval of all investment transactions.

It is recommended that the Company increase their fidelity bond coverage to the minimum $50,000 amount prescribed by the NAIC.

It is recommended that the Company expand its claims register to include columns for a claim number, date reported, amount paid, date paid, date closed and reinsurance received and that it enter claims in the register in report date order.

It is recommended that the Company amend the reinsurance agreement with Grinnell Mutual Reinsurance Company to include an entire contract clause.

It is recommended that the Company require two signatures on all checks or on all checks in excess of a minimum amount established by the Board, that all unissued checks be stored in a secure location, and that the Company place a restrictive endorsement on all checks upon receipt.

It is recommended that the Company maintain supporting documents for all cash disbursements, that the Company classify expenses in accordance with *Annual Statement Instruction Manual*, and that the Company reconcile subsidiary records to primary records on a periodic basis.

It is recommended that the Company report policy fees in the Annual Statement as premium income on line 1 of page 2 rather than as a page 2 write-in item.

It is recommended that the Company establish procedures to insure that premiums for all in-force policies are received on a timely basis from policyholders and agents.

It is recommended that the Company record annual adjustments to the book value of bonds for the accrual of bond discount and the amortization of bond premium as required by the *Annual Statement Instruction Manual.*

It is recommended that bond investments, including CUSIP number, bond description and NAIC designation, be reported in subsequent annual statements in conformity with the *Annual Statement Instruction Manual* and that the amounts reported agree with supporting documentation.

It is recommended that the Company review its stock positions for compliance with the limitations set forth in N.D. Cent. Code §§ 26.1-05-19(21)(a) and 26.1-05-19(33) and report a non-admitted asset in its annual statement in the event that the market value of stocks exceeds statutory limitations.

It is recommended that the Company classify all certificates of deposits with a term longer than one year as bonds rather than as cash on deposit if those CDs do not meet the exemption requirements cited in Bulletin 2003-3. It is also recommended that the Company classify shares in money market mutual funds as common stocks.

It is recommended that the Company limit its deposit in any one banking institution to FDIC insured amounts or obtain insurance protection covering the deposits exceeding FDIC insured limits.

It is recommended that the Company report the liability for real estate taxes and federal and state unemployment taxes as Unpaid Taxes on line 35 of page 3 and report payroll withholdings as a write-in liability on page 3 under the caption of Amounts Withheld.

It is recommended that the Company report the liability for federal income taxes as a write-in item on line 32 or line 41 of page 3.