



Financial Statements

Prince Edward Island Mutual Insurance Company

December 31, 2008

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## Auditors' report

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To the policyholders of  
Prince Edward Island Mutual Insurance Company

We have audited the balance sheet of Prince Edward Island Mutual Insurance Company as at December 31, 2008 and the statements of earnings, comprehensive income, equity 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 misstatements. 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.

*Grant Thornton LLP*

Summerside, Prince Edward Island  
February 2, 2009

Chartered Accountants

# Prince Edward Island Mutual Insurance Company

## Statement of earnings

Year Ended December 31	2008	2007
Underwriting income		
Gross premiums written	\$ 13,814,079	\$ 13,178,586
Reinsurance premiums assumed (Note 9)	25,943	27,248
Reinsurance premiums ceded (Note 9)	(1,700,464)	(1,621,019)
Net premiums written	12,139,558	11,584,815
Less: increase in unearned premiums	411,514	399,074
Net premiums earned	11,728,044	11,185,741
Claims and expenses		
Gross claims incurred	8,427,152	7,046,915
Adjusting, legal and appraisals	788,679	518,349
Less: reinsurance recoveries	546,285	309,692
Net claims and adjusting	8,669,546	7,255,572
Operating expenses (Page 15)	4,374,198	4,299,086
	13,043,744	11,554,658
Net underwriting loss	(1,315,700)	(368,917)
Other income		
Net investment income (Note 7)	2,278,565	2,799,865
Loss on sale of property and equipment	(814)	(2,573)
Refund from surplus from reinsurer (Note 10)	-	94,983
Miscellaneous	52,123	27,809
	2,329,874	2,920,084
Earnings before special mutual rebate	1,014,174	2,551,167
Special mutual rebate (Note 11)	-	(1,240,491)
Earnings before income taxes	1,014,174	1,310,676
Income tax expense (Note 12)		
Current	23,288	170,711
Future	187,271	89,804
	210,559	260,515
Net earnings	\$ 803,615	\$ 1,050,161

See accompanying notes to the financial statements.

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## Prince Edward Island Mutual Insurance Company

### Statement of comprehensive income

Year Ended December 31	2008	2007
Net earnings	\$ 803,615	\$ 1,050,161
Other comprehensive loss		
Change in unrealized gain on available for sale investments, net of taxes	<u>(1,553,723)</u>	<u>(344,667)</u>
Total comprehensive (loss) income	\$ <u>(750,108)</u>	\$ <u>705,494</u>

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See accompanying notes to the financial statements.

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## Prince Edward Island Mutual Insurance Company

### Statement of equity

December 31	2008	2007
Policyholders' security fund, beginning of year	\$ 31,402,019	\$ 30,351,858
Net earnings	<u>803,615</u>	<u>1,050,161</u>
Policyholders' security fund, end of year	<u>32,205,634</u>	<u>31,402,019</u>
Accumulated other comprehensive income, beginning of year	621,309	-
Transitional adjustment on adoption of new accounting policy, net of income taxes	-	965,976
Other comprehensive loss (Page 3)	<u>(1,553,723)</u>	<u>(344,667)</u>
Accumulated other comprehensive (loss) income, end of year	<u>(932,414)</u>	<u>621,309</u>
Total equity	\$ <u>31,273,220</u>	\$ <u>32,023,328</u>

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See accompanying notes to the financial statements.

# Prince Edward Island Mutual Insurance Company

## Balance sheet

December 31 2008 2007

### Assets

#### Current

Cash and short term deposits	\$ 325,069	\$ 1,763,031
Receivables (Note 4)	1,267,539	1,177,454
Income tax receivable	398,010	480,183
Prepaid items	35,303	17,924
Deferred premium acquisition expenses	949,355	929,275
Re-insurers' share of provision for unpaid claims and adjustment expenses	<u>1,229,156</u>	<u>1,456,991</u>
	<b>4,204,432</b>	5,824,858

Investments (Note 5)	41,134,263	38,957,921
Property and equipment (Note 6)	589,198	524,854
Future income taxes	<u>17,369</u>	<u>17,629</u>
	<b>\$ <u>45,945,262</u></b>	<b>\$ <u>45,325,262</u></b>

### Liabilities

#### Current

Payables and accruals	\$ 301,161	\$ 237,201
Provision for unpaid claims	6,590,354	5,695,720
Unearned premium reserve	<u>7,780,527</u>	<u>7,369,013</u>
	<b>14,672,042</b>	13,301,934

### Equity

Policyholders' security fund (Page 4)	32,205,634	31,402,019
Accumulated other comprehensive (loss) income (Page 4)	<u>(932,414)</u>	<u>621,309</u>
	<b>31,273,220</b>	32,023,328
	<b>\$ <u>45,945,262</u></b>	<b>\$ <u>45,325,262</u></b>

On behalf of the Board

\_\_\_\_\_ Director \_\_\_\_\_ Director

# Prince Edward Island Mutual Insurance Company

## Statement of cash flows

Year Ended December 31

2008

2007

Increase (decrease) in cash and cash equivalents

<b>Operating</b>		
Net earnings	\$ 803,615	\$ 1,050,161
Depreciation	80,729	88,110
Bond premium amortized	94,053	92,095
Gain on sale of investments	(156,323)	(767,745)
Loss on sale of equipment	814	2,573
Future income taxes	187,271	89,804
	<u>1,010,159</u>	<u>554,998</u>
Income tax provision – comprehensive income (loss)	250,046	-
Change in non-cash operating working capital (Note 8)	<u>1,552,572</u>	<u>443,506</u>
	<u>2,812,777</u>	<u>998,504</u>
<b>Investing</b>		
Purchase of property and equipment	(146,958)	(111,041)
Proceeds on disposal of bonds and equities	3,480,458	5,887,585
Purchase of bonds and equities	(7,585,310)	(6,039,488)
Proceeds on disposal of property and equipment	1,071	408
	<u>(4,250,739)</u>	<u>(262,536)</u>
Net (decrease) increase in cash and cash equivalents	<u>(1,437,962)</u>	<u>735,968</u>
Cash and cash equivalents, beginning of year	<u>1,763,031</u>	<u>1,027,063</u>
Cash and cash equivalents, end of year	<u>\$ 325,069</u>	<u>\$ 1,763,031</u>

See accompanying notes to the financial statements.

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# Prince Edward Island Mutual Insurance Company

## Notes to the financial statements

December 31, 2008

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### 1. Nature of operations

The Company is incorporated without share capital under the laws of Prince Edward Island and is subject to the Prince Edward Island Insurance Act. It is licensed to write property and casualty insurance in Prince Edward Island.

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### 2. Summary of significant accounting policies

#### **Depreciation**

Depreciation of fixed assets is recorded on the diminishing balance method at the rates indicated in Note 6.

#### **Unearned premium reserve**

The unearned premium reserve is based on the unexpired term of all policies of the Company in force as at December 31.

#### **Deferred premium acquisition expenses**

Deferred premium acquisition expenses are those expenses such as agents' commissions, which relate directly to the acquisition of premiums. These expenses, to the extent that they are considered recoverable, are deferred and amortized over the terms of the related premiums.

#### **Provision for unpaid claims and adjusting expenses**

The provision for unpaid claims represents an estimate for the full amount of all costs including investigation and the projected final settlements of reported claims and for claims incurred but not reported prior to the balance sheet date. These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. These provisions are adjusted up or down as additional information affecting the estimated amounts become known during the course of claims settlement. All changes in estimates are recorded as incurred claims in the current period.

#### **Premium revenues**

Premiums are recognized as earned over the term of the policy on a pro rata basis.

#### **Income taxes accounting policy**

The Company uses the tax liability method for determining income taxes. Under this method, future tax assets and liabilities are determined according to differences between their respective carrying amounts and tax basis. Future tax assets and liabilities are measured based on enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which these temporary differences are expected to reverse.

#### **Reinsurance**

The Company reflects reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to reinsurance and its obligations to policyholders.

#### **Cash and cash equivalents**

Cash and cash equivalents include cash on hand, balances with banks and short term deposits with original maturities of one year or less.

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# Prince Edward Island Mutual Insurance Company

## Notes to the financial statements

December 31, 2008

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### 2. Summary of significant accounting policies (cont'd)

#### Use of estimates

In preparing the Company's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates used in these financial statements.

#### Financial Instruments

The Company's financial assets are classified as held for trading (HFT), held to maturity (HTM), available for sale (AFS), or loans and receivables (L&R). Financial liabilities are classified as HFT or other financial liabilities (OFL). Financial assets and liabilities are initially recognized at fair value with subsequent measurement based on classification. The classification depends on the purpose for which the financial instruments were acquired, their characteristics and choice where applicable.

All financial instruments, including derivatives, are measured at fair value except for L&R, HTM and OFL which are measured at amortized cost using the effective interest method. Unrealized gains and losses on available for sale investments are recognized in other comprehensive income until the financial asset is derecognized or other than temporarily impaired, at which time any unrealized gains or losses are recorded in net earnings.

Accumulated other comprehensive income is included in the balance sheet as a separate component of equity (net of income tax) and includes net unrealized gains or losses on available for sale assets.

Fair values are based on quoted market values where available from active markets, otherwise fair values are estimated using a variety of valuation techniques and models.

The Company has classified its financial assets and liabilities, as follows:

Cash and cash equivalents - as held for trading; Receivables - as loans and receivables, which are measured at amortized cost; Bonds, term deposits and guaranteed investment certificate financial instruments - as held to maturity; Equity financial instruments - as available for sale; Accounts payable and accrued liabilities, refund due to policyholders, amounts due to reinsurers and other insurance companies - as other financial liabilities, which are measured at amortized cost.

#### Fair values

The estimated fair values of financial instruments are intended to approximate values at which these instruments could be exchanged in a current market.

No fair values have been determined for property and equipment, or any other asset or liability that is not a financial instrument. The fair values of cash and cash equivalents, receivables, and payables and accruals are assumed to approximate their carrying values due to the short term nature of these financial instruments.

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# Prince Edward Island Mutual Insurance Company

## Notes to the financial statements

December 31, 2008

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### 3. Future changes in accounting policies

#### 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. Management understands there are differences between current Canadian GAAP and IFRS, and have undertaken a project to understand the possible future effects on the financial statements.

#### Financial instruments

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. Prior year financial statements have not been restated.

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.

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### 4. Receivables

	<u>2008</u>	<u>2007</u>
Policyholders for premiums	\$ 818,156	\$ 736,247
Accrued interest	443,074	439,952
Other	<u>6,309</u>	<u>1,255</u>
	<u>\$ 1,267,539</u>	<u>\$ 1,177,454</u>

# Prince Edward Island Mutual Insurance Company

## Notes to the financial statements

December 31, 2008

<b>5. Investments</b>	<b>2008</b>	<b>2007</b>
Held to maturity, investments at cost	<b>\$ 33,882,264</b>	\$ 31,693,392
Available for sale, investments at carrying value	<b>7,251,999</b>	7,264,529
	<b>\$ 41,134,263</b>	\$ 38,957,921

	<u>2008</u>		<u>2007</u>	
	<u>Cost</u>	<u>Carrying Value</u>	<u>Cost</u>	<u>Carrying Value</u>
<b>Held to maturity - investments</b>				
Term deposits and GIC's	\$ 2,300,000	\$ 2,300,000	\$ 2,900,000	\$ 2,900,000
Bonds at par less unamortized purchase discounts and premiums				
Federal	600,835	659,374	700,756	738,775
Provincial	14,451,009	16,265,179	15,244,523	16,756,200
Municipal	6,191,003	6,418,564	3,448,832	3,595,781
Corporate	10,339,417	9,662,284	9,399,281	9,052,437
Total bonds	<u>31,582,264</u>	<u>33,005,401</u>	<u>28,793,392</u>	<u>30,143,193</u>
Total held to maturity investments	<u>\$ 33,882,264</u>	<u>\$ 35,305,401</u>	<u>\$ 31,693,392</u>	<u>\$ 33,043,193</u>
<b>Available for sale - investments</b>				
Equities - Canadian				
Common stock	\$ 6,218,347	\$ 5,241,934	\$ 4,927,525	\$ 5,705,756
Equities - US				
Common stock	<u>2,218,121</u>	<u>2,010,065</u>	<u>1,530,693</u>	<u>1,558,773</u>
Total available for sale investments	<u>\$ 8,436,468</u>	<u>\$ 7,251,999</u>	<u>\$ 6,458,218</u>	<u>\$ 7,264,529</u>

### Held to maturity investments - maturity profile

	<u>Within 1 Year</u>	<u>1 to 5 Years</u>	<u>5 to 10 Years</u>	<u>10 to 20 Years</u>	<u>Total</u>
Bonds	\$ 1,718,000	\$ 9,475,133	\$ 13,663,616	\$ 6,725,515	\$ 31,582,264
Term deposits	<u>1,120,000</u>	<u>1,180,000</u>	-	-	<u>2,300,000</u>
Total	<u>\$ 2,838,000</u>	<u>\$ 10,655,133</u>	<u>\$ 13,663,616</u>	<u>\$ 6,725,515</u>	<u>\$ 33,882,264</u>
Percent of total	<u>8%</u>	<u>32%</u>	<u>40%</u>	<u>20%</u>	<u>100%</u>

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

# Prince Edward Island Mutual Insurance Company

## Notes to the financial statements

December 31, 2008

6. Property and equipment				<u>2008</u>	<u>2007</u>
	<u>Rate</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Land		\$ 132,097	-	\$ 132,097	\$ 132,097
Building	5%	578,400	\$ 282,857	295,543	204,658
Office equipment	20%	214,578	145,237	69,341	66,802
Computer equipment	30%, 45%	193,520	161,497	32,023	36,567
Motor vehicle	30%	188,033	131,528	56,505	80,721
Parking lot	8%	13,715	10,026	3,689	4,009
		<u>\$ 1,320,343</u>	<u>\$ 731,145</u>	<u>\$ 589,198</u>	<u>\$ 524,854</u>

7. Investment income	<u>2008</u>	<u>2007</u>
Interest from bonds and short term deposits	\$ 1,850,886	\$ 1,767,676
Dividend income	271,356	264,444
Gain on sale of investments	156,323	767,745
	<u>\$ 2,278,565</u>	<u>\$ 2,799,865</u>

8. Change in non-cash operating working capital	<u>2008</u>	<u>2007</u>
Receivables	\$ (90,085)	\$ (64,751)
Prepaid expenses	(17,379)	(1,178)
Deferred premium acquisition expenses	(20,080)	7,302
Re-insurers' share of provision for unpaid claims	227,835	(256,162)
Payables and accruals	63,960	(10,658)
Income taxes	82,173	(640,713)
Unpaid claims	894,634	1,010,592
Unearned premiums	411,514	399,074
	<u>\$ 1,552,572</u>	<u>\$ 443,506</u>
Income taxes paid	\$ 171,252	\$ 811,424

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# Prince Edward Island Mutual Insurance Company

## Notes to the financial statements

December 31, 2008

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### 9. Reinsurance

All reinsurance is ceded and assumed from Farm Mutual Reinsurance Plan Inc., a mutual reinsurer incorporated without share capital, of which the Company is a member.

#### Reinsurance ceded

The Company follows the policy of underwriting and reinsuring contracts of insurance which, in the main limits the liability of the Company to a maximum amount on any one property loss to \$415,000 or liability loss to \$199,000. The reinsurance contracts also limit the Company's liability on the sum of all individual losses arising out of one event to \$1,200,000. In addition, the Company has obtained reinsurance which limits the Company's overall liability on losses to a maximum of 80% of the Company's earned premium.

#### Reinsurance assumed

The Company is participating as a re-insurer of losses from catastrophe suffered by members of the Farm Mutual Reinsurance Plan Inc. to the extent of \$150,000 for a single catastrophe loss. The Company's participation commences if a catastrophe loss exceeds \$15 million and reaches the limit of \$150,000 if the loss is \$120 million or greater.

The Company is also participating with a group of Canadian mutual insurance companies as a re-insurer of Agricorp, a crown corporation in Ontario, that provides crop insurance to Ontario farmers. The Company's maximum exposure in any one year is \$150,000.

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### 10. Refund from surplus from reinsurer

In 2007, the Board of Directors of Farm Mutual Reinsurance Plan Inc., our reinsurer, declared a refund from surplus payable to qualifying member companies. Our proportionate share of the refund was \$94,983. There was no refund declared in 2008.

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### 11. Special mutual rebate

The Board of Directors declared a Special Mutual Rebate in 2007, payable to all policyholders with policies in force on December 31, 2006, at a rate of 10% of gross written premiums on December 31, 2006.

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### 12. Income taxes

Forty percent (40%) of premiums are from farming and fishing producers. The Company is taxable on the portion of its income that is attributed to non-farming/fishing premiums.

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### 13. Pensions

The Company has a defined contribution plan providing pension benefits to eligible employees. The total plan expense for the Company's defined contribution plan for all of 2008 was \$127,097 (2007 - \$127,521).

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# Prince Edward Island Mutual Insurance Company

## Notes to the financial statements

December 31, 2008

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### 14. 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 the Company's exposure to \$1.2 million plus 5% of the remaining loss. The \$1.2 million net retained amount represents approximately 4% of Company's capital. For the purpose of capital management, the Company has defined capital as policyholders' security fund, excluding accumulated other comprehensive income (loss).

Section 317.(1) of the Insurance Act of Prince Edward Island requires insurers to maintain a reserve fund equal to the sum of \$500 for every \$100,000 of the first \$1 million of insurance in force, and \$3,000 for each additional \$1 million or part thereof insurance in force. The Company's reserve fund as at December 31, 2008 was 1.8 times that which is required by S317.(1) of the Insurance Act.

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### 15. Financial instrument risk management:

#### Credit risk

Credit risk is the risk of financial loss to the Company if a debtor fails to make payments of interest and principal when due. 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 includes guidelines on the bond portfolio relating to portfolio composition, issuer type, bond quality ratings (at time of acquisition - rated as "A" or better) and general guidelines for geographic exposure. All fixed income portfolios are monitored by management on a monthly basis.

Reinsurance is placed with 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 5.

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.

The Company's investment policy operates within the guidelines of the 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.

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# Prince Edward Island Mutual Insurance Company

## Notes to the financial statements

December 31, 2008

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### 15. Financial instrument risk management (cont'd)

#### 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 25% in accordance with its investment policy. 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 \$20,101 which would be reflected in net income or OCI.

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

#### 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 not exposed to this risk as its interest bearing investments are being held to maturity.

#### 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 \$725,000. 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 (losses) in income during the period.

#### Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet all cash outflow obligations as they come due. The Company mitigates this risk by monitoring cash activities and expected outflows. Our current liabilities arise as claims are made. We do not have material liabilities that can be called unexpectantly 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 including investment 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.

## Prince Edward Island Mutual Insurance Company

### Schedule of expenses

Year Ended December 31	2008	2007
Advertising	\$ 131,660	\$ 107,780
Canada pension plan	79,733	76,969
Conventions, courses and travel	97,727	80,375
Depreciation	65,674	62,743
Directors fee	206,925	203,633
Donations	78,283	65,000
Employment insurance	37,691	37,274
Fire prevention tax	138,141	131,786
Group insurance	102,911	96,865
Loss prevention	117,810	125,966
Office supplies	99,674	96,812
Other administration costs	192,463	191,931
Postage	113,502	120,787
Premium acquisition expenses	1,665,485	1,685,431
Professional fees	23,467	25,958
Salaries	1,129,880	1,102,760
Taxes, dues and licences	36,847	32,552
Telephone	56,325	54,464
	<u>\$ 4,374,198</u>	<u>\$ 4,299,086</u>